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Supreme Court, U.S.
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No.

In the

Supreme Court of the United States

ELWOOD J. LEBLANC, JR.,
and JANICE L. LEBLANC,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Thomas E. Redding,
Counsel of Record
Sallie W. Gladney,
Teresa J. Womack,
Redding & Associates, P.C.
2914 West T.C. Jester
Houston, TX 77018
(713) 965-9244
Attorneys for Petitioners

QUESTIONS PRESENTED

1. Whether dismissal for lack of jurisdiction under 26 U.S.C. §7422(h) was an erroneous "drive by" jurisdictional ruling as described in *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 126 S.Ct. 1235, 163 L.Ed. 2d 1097 (2006) and *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998) that should be reversed and remanded for proceedings on the merits.

2. Whether §7422(h), which bars claims for refund attributable to a "partnership item," denies the United States Court of Federal Claims jurisdiction over partner-level refund suits for loss of the partner's personal basis in a terminated partnership, which is an "affected item."

3. Whether a transaction that lacks economic substance is disregarded for all tax purposes or disregarded only for those tax purposes benefitting the taxpayer.

PARTIES TO THE PROCEEDINGS BELOW

The following were the parties to the proceedings below before the United States Court of Federal Claims and the Court of Appeals for the Federal Circuit:

Elwood J. LeBlanc,

Janice L. LeBlanc, and

the United States of America.

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OPINIONS BELOW

The Federal Circuit opinion is unpublished but can be found at *LeBlanc v. U.S.*, 2011 WL 379305 (Fed. Cir. 2011) ("*LeBlanc* II"). App. 1-6.[1] The opinion of the Court of Federal Claims is reported at *LeBlanc v. U.S.*, 90 Fed. Cl. 186 (2009) ("*LeBlanc* I"). App.7-57.

The directly conflicting opinions are:

Henderson v. Shinseki, – U.S. – , 131 S. Ct. 1179, – L.Ed.2d –, (2011); *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006); and *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998), which distinguish between subject-matter jurisdiction and decisions based on the merits of a claim for relief;

Petaluma FX Partners, LLC v. C.I.R., 591 F.3d 649 (D.C.Cir. 2010), and *Jade Trading, LLC v. U.S.*, 598 F.3d 1372 (Fed.Cir. 2010), which hold a partner's affected item, basis-related refund claims cannot be raised in TEFRA partnership-

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[1] References to "App. x" are to page "x" of the attached Appendix.

level proceedings but must be raised at the individual partner level, which was the holding of the *LeBlanc* I trial court; and

Field v. U.S., 328 F.3d 58 (2nd Cir. 2003); *Prochorenko v. U.S.*, 243 F.3d 1359 (Fed.Cir. 2001); and *Monti v. U.S.*, 223 F.3d 76 (2nd Cir. 2000), which hold that 26 U.S.C. §7422(h) should be narrowly and literally applied only to refunds directly attributable to partnership items and not to affected item refund claims.

JURISDICTION

The judgment of the Federal Circuit was filed on February 7, 2011. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant statutes, and regulation are set forth in the appendix to this petition. App. 93-112.

STATEMENT OF THE CASE[2]

1. Summary of the Argument

This case was erroneously dismissed for lack of jurisdiction in a "drive by jurisdictional" ruling exactly as this Court forbade in *Arbaugh* and *Steel*, and as recently extended to Article I courts in *Henderson*. Erroneous jurisdictional rulings have become common in cases like this that are subject to TEFRA's complex, bifurcated jurisdictional structure which turns on classification of tax items as "partnership items" or "nonpartnership items."

The LeBlancs filed a claim for refund for a loss of tax basis on abandonment of their interest in a partnership. It is well-settled and undisputed that a partner's tax basis in a partnership is an "affected item." Therefore, the LeBlancs' claim was attributable to an affected item.

The trial court correctly found it had jurisdiction over the claim but, based on its calculations, held the LeBlancs had zero partnership basis. The LeBlancs appealed the trial court's merit-based decision.

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[2] Unless otherwise stated, references to "Section," "sec.", "§" are to the Internal Revenue Code ("Tax Code") at 26 U.S.C.

The Federal Circuit dismissed the claim for lack of jurisdiction pursuant to §7422(h), which bars partner-level refund claims attributable to partnership items. The court held the claim challenged the disallowance of partnership deductions for "lack of economic substance," which the trial court equated to shams and found to be a partnership item.

The Federal Circuit's holding is at odds with the great weight of law. The LeBlancs ask the Court to reverse and remand for further consideration of the merits of their claim.

2. Facts and Statement of the Case

In the early 1980s, American Agri-Corp, Inc. ("AMCOR") organized over 200 limited partnerships. In 1986, the LeBlancs invested as limited partners in one AMCOR partnership, Agri-Cal Venture Associates ("ACVA"). In 1986 ACVA reported farming expenses and other deductions. The LeBlancs reported their pro rata share of those deductions on their 1986 tax return. Subsequently, the LeBlancs reported and paid tax on income passed through to them from ACVA until they abandoned that partnership interest in 1999.

In the late 1980s, the IRS examined some of the AMCOR partnerships. Those examinations

and this suit are subject to the TEFRA[3] unified partnership examination procedures. The IRS proposed to totally disallow all of the deductions of 43 AMCOR partnerships, including ACVA's 1986 deductions. Among the IRS's shotgunned, alternative reasons to entirely disallow the deductions was "[t]he partnership's activities constitute a series of sham transactions" and, alternatively, "[t]he partnership's activities lack economic substance."

Petitions challenging the partnership item adjustments were filed by partners other than LeBlanc in the United States Tax Court, including a petition challenging the ACVA adjustments.[4] Barring other exceptions not at issue here, *arguendo*, the LeBlancs were parties to the ACVA Tax Court suit.

While the Tax Court suits were pending, the IRS invited the partners to settle on

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[3] Partnership procedures codified at 26 U.S.C. §§6221-6233 by the Tax Equity and Fiscal Responsibility Act of 1982, Pub.L. No. 97-248, 96 Stat. 324 ("TEFRA"). Effective for tax years after September 3, 1982. *See generally Maxwell v. C.I.R.*, 87 T.C. 783 (1986).

[4] *Agri-Cal Venture Assoc's v. C.I.R.*, Docket No. 12530-90.

substantially identical IRS-promulgated Forms 870-P(AD) that differed only by partnership as to the tax year and amount of deduction allowed. No grounds were identified for the agreed adjustments. Roughly half the AMCOR partners settled.

As AMCOR partners settled, the IRS filed Rule 248(c) notices with the Tax Court, representing that "pursuant to section 6231(b)(1)(C), such partnership items became nonpartnership items as of the date the settlement agreement was executed on behalf of Respondent and, pursuant to section 6226(d)(1)(A), [the partner] is no longer a party to the proceeding."[5]

When the IRS sent the settled partners notice of the amount of personal liability resulting from their partnership item settlements, it also notified them that they could file refund claims related to the loss of their partnership basis.

In January of 2000, IRS Special Trial

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[5] The LeBlancs request that this Court take judicial notice of the settlement notices the Internal Revenue Service filed with the Tax Court in the *Agri-Cal* case (Docket No. 012530-90) at docket entries 68, 69, 70, 74, 92, 93, 99, and 103.

Attorney Alice M. Harbutte instructed the TEFRA Technical Unit to compute and pay the then-pending 2000 AMCOR related basis claims as capital losses using the tax liability that resulted from the settlement as the amount of lost basis. App. 121-124. Harbutte's shorthanded basis calculation closely approximated most partners' actual ending basis and avoided complex, time consuming calculations necessary to determine each partner's actual ending basis – usually 10 years of calculations for each partnership. Harbutte also instructed the IRS that the claims should be paid under §6230(c)(1) because the IRS failed to allow a refund attributable to the application of a settlement. App.122. The IRS subsequently paid the AMCOR basis claims that requested capital loss treatment.

After obtaining a special enlargement of time to settle, the LeBlancs signed and returned a Form 870-P(AD) for ACVA for 1986, which the IRS accepted and processed as a §6224(c) "Consistent Settlement" on June 16, 2000. That Form 870-P(AD) settlement allowed approximately half of the deductions the IRS had previously proposed to totally disallow. The Form 870-P(AD) agreed to only numeric adjustments to partnership

deductions and did not identify any grounds for the adjustments. The IRS was not required to and did not file Rule 248(c) notices for the LeBlancs.

The LeBlancs' partnership items converted to nonpartnership items and they ceased to be parties to the TEFRA case when they settled on June 16, 2000.

In April of 2001, the IRS filed motions to enter agreed decisions approved by the Tax Matters Partner in the ACVA partnership-level suit. The Tax Court entered those agreed decisions on July 19, 2001. The decisions recited that the adjustments to partnership income and expense were attributable to transactions "which lacked economic substance . . . so as to result in a substantial distortion of [partnership income and/or expense]." App.117.

On May 24, 2002, the LeBlancs filed a claim for refund based on a loss equal to their basis in their ACVA partnership interest when they abandoned that interest. Their claim referenced and incorporated Harbutte's shorthand explanation for calculating the amount of remaining basis but was clearly based on the LeBlancs' final, actual basis in ACVA that took into account their recognition

of partnership income from 1987-1999. However, because their partnership interest was terminated by abandonment, instead of taking a capital loss they claimed an ordinary loss pursuant to controlling precedent, Rev. Rul. 93-80, and IRS Publication 541. The IRS denied the LeBlancs' basis claim.

Under 28 U.S.C. §§1346(a) and 1491(a), the LeBlancs filed suit in the Court of Federal Claims (the "CFC"). The case was stayed until 2007. Upon re-opening, the Government filed a motion to dismiss pursuant to Rule 12(b)(1) and (6), asserting Harbutte's short-handed basis calculation meant the claim was for a refund resulting from the partnership item settlement.

After argument on the Rule 12(b) motion, the court ordered the LeBlancs to amend their complaint to clarify that the basis claim did not rest on Harbutte's short-hand basis calculation. The Government moved for summary judgment on the amended complaint, asserting the court lacked subject-matter jurisdiction over the claim pursuant to §7422(h) because the claim challenged the alleged sham nature of the partnership's transactions. Alternatively, the Government asserted the LeBlancs had no tax basis on which to claim a loss. The CFC held the court

had jurisdiction over the claim but held on the merits that the LeBlancs' basis at the time of abandonment was zero.

The LeBlancs timely appealed to the Federal Circuit under 28 U.S.C. §1295(a)(3). Following *de novo* review, the Federal Circuit reversed as to jurisdiction, holding the claim was barred by §7422(h). In an abbreviated opinion, the court relied on prior analysis and holdings in *Schell*[6] and *Keener* II[7] as authority.

3. TEFRA's Bifurcated Jurisdiction

Partnerships generally do not pay income tax; they file information returns.[8] Instead, each partner reports his share of partnership income, gains, losses, deductions, etc., and recognizes any resulting benefit or tax (if any) on his individual return.[9] Before 1982, to

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[6] *Schell v. U.S.*, 589 F.3d 1378 (Fed.Cir. 2009). App.80-92.

[7] *Keener v. U.S.*, 551 F.3d 1358 (Fed.Cir. 2009) ("*Keener* II"). App.58-79. The *Schell* court also relied on *Keener v. U.S.*, 76 Fed.Cl. 455 (2007) ("*Keener* I"). App. 91-92.

[8] *Conway v. U.S.*, 50 Fed.Cl. 273, 276 (2001).

[9] §§701, 702, 6031; Treas.Reg.§1.701-1; 1.702-1(a); 1.6031-1.

adjust an item reported on a partnership's return, the IRS separately examined and adjusted each partner's individual return, which required duplicative examinations. In response, Congress enacted TEFRA to consolidate some partnership audit and adjustment procedures. For tax years prior to 1997, the TEFRA audit, adjustment, and refund procedures are bifurcated between partnership- and partner-level proceedings that turn on the mutually exclusive categories of "partnership items" and "nonpartnership items."[10]

a. Partnership Item Jurisdiction

"Partnership items" are:

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle [F], such item is more appropriately determined at the

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[10] See *Callaway v. C.I.R.*, 231 F.3d 106,107-113 (2nd Cir. 2000) and *Weiner v. U.S.*, 389 F.3d 152, 154-55 (5th Cir. 2004). This bifurcated system was substantially amended, effective for tax years beginning after August 5, 1997. Taxpayer Relief Act of 1997, P.L.105-34 §§1238(b) and 1239(b).

partnership level than at the partner level.[11]

TEFRA mandates that partnership items can only be determined at the partnership level.[12]

To adjust a partnership item, the IRS must first issue a Notice of Final Administrative Adjustment ("FPAA"), which explains the IRS's proposed partnership item adjustments and the grounds therefore.[13] Judicial review of an FPAA and the partnership item adjustments therein is limited to a single partnership-level suit. For pre-1997 tax years, jurisdiction in that proceeding is expressly and exclusively restricted to the readjustment and allocation of partnership items.[14]

Consistent with the statutory requirement that partnership items can be considered only

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[11] §6231(a)(3). App. 104.

[12] §6221; see also §§6216(4), 6223, 6224(c), 6225(a), 6226, 6230(a)(1), 6231(a)(3); Temp.Treas.Reg. §301.6221-1T(a); *Callaway*, 231 F.3d, at 110. App. 93-106.

[13] §6223(a)(2) and (d)(2). App. 94.

[14] §6226(a), (b), and (f). App. 97-100.

in partnership-level proceedings, §7422(h) bars jurisdiction over any partner-level claim for a "refund attributable to partnership items (as defined in §6231(a)(3)) except as provided in §6228(b) or §6230(c)."[15]

Generally, all partners are deemed parties to any partnership-level suit.[16] But two categories of partners are expressly barred: 1) those whose partnership items have converted to nonpartnership items (usually by settlement or bankruptcy), and 2) those whose assessment period has expired.[17] As relevant here, the partnership items of a settled partner become nonpartnership items on settlement and the partner is no longer a party to the partnership-level proceedings.[18] Because they

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[15] §7422(h). App.109. One exception under §6230(c)(1)(B) is IRS failure to make a credit or refund attributable to the application of a settlement. Harbutte advised the TEFRA Technical Unit to pay the AMCOR basis refund claims pursuant to §6230(c)(1)(B). App. 122.

[16] §6226(c). App. 99.

[17] §6226(d)(1)(A) and (B). App. 99.

[18] §6224(c)(1) and (2), Temp.Treas.Reg. §301.6224(c)-3T(a) and (b) (effective for pre-1997 tax years), §6231(b)(1)(C), and §6226(d)(1)(B). App. 95, 99, 105,

are no longer parties, they cannot be bound by the partnership level suit.[19]

Only partners with an interest in the outcome can participate in the partnership-level suit.[20] All non-excluded partners are parties. However, under the Tax Court's Rules, only partners who are "participating partners" may take part in the litigation. Participating partners are those who file either (i) the petition or (ii) a notice of election to participate.[21] A partner's status as "participating" or "nonparticipating" is relevant only to certain notice requirements and whether he may actively participate. It is irrelevant to the Tax Court's jurisdiction.

After the partner's partnership items are determined, *e.g.*, by a partner's settlement (as here), the IRS can assess any directly resulting

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and 112.

[19] §§6226(d) and 6228(a)(4)(B); Tax Court Rules 245(b) and 247(a). App.99,101,113-114. IRS Field Service Advisory 199950008, 1999 WL 1208429, December 17, 1999 (settled partners are no longer parties to the partnership-level proceedings).

[20] §6226(c) and (d). App.99.

[21] Rules 245(b) and 247(b). App. 113-114.

tax against that partner. In any later partner-level proceeding, those partnership item determinations are binding and can be applied but not challenged by the partner or the IRS.[22]

b. Nonpartnership Item and Affected Item Jurisdiction

A nonpartnership item is any "item which is (or is treated as) not a partnership item."[23] After the partner's partnership items are determined, that partner's related *non*partnership items are then addressed, usually under the normal subchapter B deficiency procedures.[24] There are two types of nonpartnership items: pure nonpartnership

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[22] §§6224(c), 6226(g) and (h), 7422(h). App. 95, 100, and 109. *Jade Trading v. U.S.*, 80 Fed.Cl. 11, 42 n.62 (2007) ("An affected item is a nonpartnership item but to the extent a determination of a partnership item affects the item, the determination at the partnership-level is conclusive at the partner-level.").

[23] §6231(a)(4). App. 104.

[24] *Maxwell*, 87 T.C., at 788; *Callaway*, 231 F.3d, at 108, 110; §6230 (subchapter N non-TEFRA procedures – §§6211-6216 – apply to assessments attributable to nonpartnership/affected items that cannot be assessed by means of computational adjustments.).

items and affected items.

Pure nonpartnership items are items completely unrelated to the partnership and are not affected by changes to partnership items, *e.g.*, rental income from property unrelated to the partnership.

An affected item is "any item to the extent such item is affected by a partnership item."[25] Affected items have partnership- and nonpartnership-item components.

For pre-1997 tax years, the scope of partnership-level proceedings is statutorily limited to partnership items.[26] A corollary to that restriction is that other items,

including affected items, cannot be determined in partnership-level proceedings and, therefore, can only be brought at the partner level. See *Petaluma* and *Jade Trading* discussion below.

Consequently, any partnership-item component of an affected item is determined at

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[25] §6231(a)(5). App. 104. It is well settled that *some* affected items have a partnership item *component*. *See N.C.F. Energy v. C.I.R.*, 89 T.C. 741, 743-4 (1987).

[26] *E.g.*, see *N.C.F. Energy*, 89 T.C., at 744. See also *Petaluma* and *Jade Trading*.

the partnership-level and is conclusive as to all partners subject to that determination.[27] The partnership-item component determination is then applied to the affected item. Pursuant to §7422(h), that partnership-item component cannot be redetermined at the partner level.[28] But §7422(h) does not bar (or even mention) refunds attributable to affected items (as defined in §6231(a)(5)). App. 109.

It is well settled and undisputed in this case that a partner's basis in his partnership (sometimes called "outside basis") is an affected item, not a partnership item.[29]

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[27] That determination may be by a settlement binding only on that partner, like the LeBlancs' 870-P(AD), or in a TEFRA proceeding binding on the parties to that proceeding, or based on the partnership return as filed if no FPAA was ever issued. §§6224(c), 6226. App. 95-100. *Roberts v. C.I.R.*, 94 T.C. 853,at 860-862 and n.6 (1990).

[28] *Jade Trading*, 598 F.3d, at 1378-80.

[29] *Dial U.S.A., Inc., v. C.I.R.*, 95 T.C. 1, 5-6 (1990) (basis is not a partnership item because it is not required to be taken into account for the taxable year under subtitle A); *Univ. Heights at Hamilton Corp v. C.I.R.*, 97 T.C. 278, 281-282 (1991) (basis is an affected item because a partner's basis is partially comprised of partnership items, such as debt).

REASONS TO GRANT THE PETITION

The Government and the courts below did not dispute that 28 U.S.C. §§1346(a) and 1491(a) provide the CFC with general jurisdiction over claims for refunds of tax and that sovereign immunity is waived under §7422(a), which provides a substantive right to recovery against the United States for any internal revenue tax alleged to have been erroneously or illegally assessed or collected. The primary issue before the Court is whether the Federal Circuit erred in dismissing the partners' affected-item basis refund claims for lack of subject-matter jurisdiction under §7422(h).

1. The Partnership Item and Affected Affected Item Jurisdiction Issue Impacts Thousands of Taxpayers

TEFRA's bifurcated jurisdictional scheme impacts millions of partnerships and individual partners.[30]

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[30] The IRS received 3,307,000 partnership returns for 2008. IRS Data Book Table 2, Number of Returns Filed, by Type of Return, Fiscal Years 2007 and 2008, http://irs.gov/pub/irs-soi/08db02nr.xls.

Just with respect to the AMCOR partnerships, over 2000 basis claims were filed with the IRS. AMCOR partners also filed hundreds of affected-item refund claims on other grounds, *e.g.*, §6621(c) and limitations.[31] After 12 years of litigation, there are still roughly 100 AMCOR-related refund suits currently pending in the CFC and various district courts that await coherent, consistent jurisdictional guidance.

Thousands of other taxpayers have been impacted by this same jurisdictional uncertainty in other partnership cases. In the Hoyt cattle and sheep cases, the Tax Court and the Ninth Circuit struggled for years to resolve jurisdiction in dozens of partnership-and partner-level cases that affected hundreds of partners.[32] Approximately 5,000 investors

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[31] *E.g.*, *Weiner*; *Keener* II; *Prati v. U.S.*, 603 F.3d 1301 (Fed.Cir. 2010); and *Duffie v. U.S.*, 600 F.3d 362 (5th Cir 2010).

[32] See *River City Ranches #1 Ltd. v. C.I.R.*,40 F.3d 1136 (9th Cir. 2005), reversing T.C.Memo 2003-150, 2003 WL 21205284 (2003); *Keller v. C.I.R.*, 568 F.3d 710 (9th Cir. 2009); and *Keller v. C.I.R.*, 556 F.3d 1056 (9th Cir.2009) (all considering whether §6621(c) penalty interest and the §6662 accuracy related penalty are determined at the partnership- or partner-

participated in "Son of Boss" transactions.[33] At least four circuits have struggled with jurisdiction over the §6662 penalty and §6664 defense that impact the "Son of Boss" investors.[34] As discussed below, the great weight of precedent, including the Hoyt and Son of Boss cases, is inconsistent with the jurisdictional determination in *LeBlanc* II and the Federal Circuit's other AMCOR decisions.

2. *LeBlanc* II Is Inconsistent With This Court's Jurisdictional Mandate

In recent years the Court has clarified the application of "jurisdiction," which broadly refers to "a court's adjudicatory authority" but is limited to subject-matter and personal

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level).

[33] 2004 Tax Notes Today 109-2 (June 4, 2004) (remarks of Commissioner Everson).

[34] *E.g.*, *Jade Trading*, 598 F.3d, at 1378-1380; *Stobie Creek Invs. LLC v. U.S.*, 608 F.3d 1366, 1380 (Fed.Cir. 2010); *Petaluma*, 591 F.3d at 652-656; *Am. Boat Co., LLC v. U.S.*, 583 F.3d 471, 478-80 (7th Cir. 2009); *Klamath Strategic Inv. Fund ex rel. St. Croix Ventures v. U.S.*, 568 F.3d 537, 548 (5th Cir. 2009).

jurisdiction.[35] The Court has repeatedly admonished courts for making what it calls "drive-by jurisdictional rulings,"[36] *i.e.*, stating a claim or suit is being dismissed for "lack of jurisdiction" when it is actually resolved on nonjurisdictional grounds. Two of the most common misuses of jurisdiction identified by the Court are

- conflation of jurisdiction with the merits of a material element of a cause of action,[37] and
- exercising "hypothetical jurisdiction" to decide the merits and then converting the merits determination into a jurisdictional holding.[38]

Here the Federal Circuit improperly conflated merits with jurisdiction and implicitly exercised "hypothetical jurisdiction."

The LeBlancs asked for a refund related to their outside basis loss, an affected item. In

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[35] *Reed Elsevier, Inc. v. Muchnick et al.*, 130 S.Ct. 1237, 1243 (2010).

[36] *Steel*, 523 U.S., at 91.

[37] *Arbaugh*, 546 U.S., at 511.

[38] *Steel*, 523 U.S., at 93-4.

response the Government mistook Harbutte's short-handed basis calculation as the grounds for the claim and alleged the LeBlancs' remaining tax basis derived from the settlement of partnership items that, allegedly, had been disallowed as sham transactions. In essence the Government asserted the LeBlancs lacked profit motive, an essential element of a claim for a §165 basis loss.

The trial court was not persuaded that the claim failed because of the sham allegation. That court properly recognized it had jurisdiction because the LeBlancs' claim was based on their recognition of over a decade of subsequently reported and sustained partnership income and not the 1986 partnership item adjustments as the Government alleged.[39] The trial court also recognized that the claim presented questions involving the nonpartnership prong of an affected item, over which the court had jurisdiction because the partnership prong of that item (sham) had already been decided.

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[39] The CFC's merits determination did not turn on §165 profit motive but considered the claim in terms of §705, the grounds for recovery clarified in the LeBlancs' amended complaint. *LeBlanc* I, at 196. App. 36-57. *Schell* did not recognize that distinction.

App. 33-35.

The Federal Circuit improperly dismissed for lack of jurisdiction, finding (i) the disallowed ACVA transactions were shams, (ii) sham is a partnership item and, consequently, (iii) the LeBlancs' refund claim was attributable to a partnership item and barred by §7422(h).

The Federal Circuit improperly conflated the merits of the sham allegation, which may or may not have been an element of the LeBlancs' claim, with refund jurisdiction over that claim.

Moreover, the Federal Circuit exercised hypothetical jurisdiction. Based on *Schell*, the court made at least two merits-based findings: (i) the settlements were partial and (ii) the Tax Court decision established sham as the grounds for adjustment. The court circularly relied on those merits-based determinations to dismiss the claim for lack of jurisdiction as a challenge to sham.

The danger of drive-by jurisdictional rulings extends to the burdens born by each party. If this case is properly treated as an appeal based on the merits of the parties' cross motions for summary judgment, then the Government's motion for summary judgment would have had

to be reviewed *de novo*, following these rules:

> In considering a motion for summary judgment, the Court must believe any evidence presented by the non-moving party. ... The Court must also draw all reasonable inferences in the non-moving party's favor. ...[40]

Henderson extended the *Arbaugh* and *Steel* jurisdictional guidelines to Article I tribunals, like the Tax Court and CFC.[41] Shortly after issuing *Henderson*, the Court remanded *Mann*,[42] a federal sentencing guideline case, for further consideration pursuant to *Henderson*. The Tenth Circuit's subsequent unpublished opinion in *Springer*[43] applied *Henderson* to tax provisions in disputes before the Tax Court.

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[40] *Morton v. U.S.*, – Fed. Cl.– , 2011 W.L. 1570439 *2 (Fed.Cl.) (citations omitted).

[41] *Henderson*, 131 S.Ct., at 1204.

[42] *Mann v. U.S.*, 131 S.Ct. 1598 (2011) (mem.), remanding *U.S. v. Mann*, 373 Fed.Appx. 350, 2010 WL 1418308 (4th Cir. 2010) (unpublished), a federal sentencing guideline case, for reconsideration pursuant to *Henderson*.

[43] *Springer v. C.I.R.*, 2011 WL 199718 (10th Cir., March 14, 2011) (unpublished).

But the Government has represented to other courts in related pending tax cases that *Henderson* is strictly limited to veterans cases and that it cannot apply to tax provisions.[44] For example, in *Scott,*[45] currently pending before the Fifth Circuit, the Government's response to *Henderson* was that

> *Henderson*'s analysis in the context of veterans benefits simply has no bearing on the issues presented in the case at bar, and appellant is grasping at straws in citing it to the Court.[46]

In *Scott*, the Government's response to *Mann* was that *Henderson* is irrelevant to jurisdictional determinations in tax cases because "[l]ike *Henderson*, *Mann* involved a factual scenario and statutory scheme entirely

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[44] App. 131, 13637. The LcBlancs request that this Court take judicial notice of the materials attached at App. 126-161 which were filed with the Fifth Circuit Court of Appeals, the United States District Court for the Southern District of Texas, and the CFC, as applicable.

[45] *Scott, et al. v. U.S.* (Fifth Circuit No. 10-20425), appealed *sub nom.* from *Matthews v. U.S.*, 2010 WL 2305750 (S.D.Tex. 2010) (unpublished).

[46] App. 131.

distinct from that presented here." App. 136.

In other AMCOR-related refund cases before federal district courts and the CFC, the Government has asserted *Henderson* involved the "unique nature of the veterans' benefits claims system" and, therefore, *Henderson* does not apply to " 'ordinary civil litigation' cases" such as tax refund suits. App. 140. In cases currently pending before the CFC, the Government has responded that the application of *Henderson* to those tax refund cases is "outlandish and provides no justification for continuing this litigation." App. 143. The Government has even threatened those taxpayers' attorneys with sanctions if they continue to assert that this Court's jurisdictional analysis in *Henderson* applies to tax refund claims. App. 158-59.

The LeBlancs ask that this Court reverse the Federal Circuit's "drive-by jurisdictional ruling" as to their basis claim and apply *Henderson*, *Arbaugh*, and *Steel*. Petitioners further ask that after jurisdiction is established that this case be remanded for determination on the merits with guidance as to the meaning of "sham" and "lack of economic substance."

3. *LeBlanc* Is Inconsistent With *Nault*

The Federal Circuit's jurisdictional determination in *LeBlanc* cannot be reconciled with other AMCOR-related decisions, particularly *Nault*.[47]

In September 2002, Nault filed AMCOR basis claims asserting ordinary losses for his loss of basis in five AMCOR partnerships. Unlike the LeBlancs, he did not settle with the IRS and, presumably, remained a party to the partnership-level suits until the agreed decisions were entered. The IRS denied his claims and he filed suit in New Hampshire federal district court. The Government did not dispute jurisdiction or raise §7422(h). In 2007, the district court addressed the merits of the claims and granted summary judgment in favor of the Government.[48]

Nault appealed to the First Circuit, which reviewed the case *de novo* and affirmed the district court's holding on the merits. The First Circuit understood TEFRA jurisdiction; in the final paragraph of the opinion the court noted

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[47] *Nault v. U.S.*, 517 F.3d 2 (1st Cir. 2008).

[48] *Nault v. U.S.*, 2007 WL 465310 (D.N.H. 2007) (unpublished).

it lacked jurisdiction to make re-determinations regarding partnership transactions.

4. *LeBlanc* Is Inconsistent With Other Recent Partnership-Related Basis Cases

In *Petaluma*, a "Son of Boss" case, the D.C. Circuit construed partner basis claims from the other side of the jurisdictional divide – the partnership-level.

As in *LeBlanc*, in *Petaluma* the Government conceded a partner's outside basis is an affected item, not a partnership item but argued, nonetheless, that the elements of basis are mainly or entirely partnership items and the partnership-level tribunal had jurisdiction to make the allegedly "obvious conclusion" that a partner could not have any basis given a sham/lack of economic substance finding.[49]

In *Petaluma* the Tax Court found the partnership itself was a sham, lacked economic substance, and should be disregarded for tax purposes (a much broader ruling than the finding here that some of ACVA's transactions

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[49] *Petaluma*, 591 F.3d, at 654.

were shams).[50]

The D.C. Circuit affirmed as to sham/lack of economic substance but reversed the Tax Court's holding that it had jurisdiction over partner basis claims in partnership-level proceedings. The court recognized that under §6226(f) the partnership-level tribunal has jurisdiction to determine partnership items but not affected items and a partner's outside basis is an affected item.[51] The court correctly determined the issue was not whether it was "obvious" that a sham/lack of economic substance finding was fatal to the partners' basis claim – the issue was whether the Tax Court had jurisdiction to make the basis determination at all. As the D.C. Circuit succinctly put it:

> The fact that a determination seems obvious or easy does not expand the court's jurisdiction beyond what the statute provides. *In other words, it does not matter how low the fruit hangs when one is forbidden to pick it.* We hold that the Tax Court had no jurisdiction to determine that Petaluma's partners had

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[50] *Id*, at 651.

[51] *Id*, at 654-5.

> no outside basis in the disregarded partnership. ... If disregarding a partnership leads ineluctably to the conclusion that its partners have no outside basis, that should be just as obvious in partner-level proceedings as it is in partnership-level proceedings.[52]

The Federal Circuit subsequently issued *Jade Trading*. In that partnership-level case the CFC held the partnership's transactions lacked economic substance and should be disregarded for tax purposes. The Government asserted and the court held that penalties based on the partners' outside basis could be determined at the partnership level because most (if not all) of the components of basis are partnership items, including the legal and factual determinations that underlie the characterization of partnership items as lacking economic substance.[53]

The Federal Circuit rejected that reasoning, recognizing outside basis is an affected item that can only be determined at the partner

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[52] *Petaluma*, 591 F.3d, at 655 (emphasis added).

[53] *Jade Trading*, 598 F.3d at 1378-9.

level.[54] The Federal Circuit followed *Petaluma*, including the portion of the decision that explained §6230(c)(1) allows partners to challenge the *application* of the partnership-level, partnership-item determinations to their affected items.

The *Petaluma* and *Jade Trading* approaches to affected-item jurisdiction cannot be reconciled with *LeBlanc*.

5. Mishandling of Jurisdictional Issues under TEFRA Is A Recurring Issue

This *ad hoc* jurisdictional approach to affected-item jurisdiction exhibited by *LeBlanc*, *Nault*, *Petaluma* and *Jade Trading* can be seen in other affected item cases.

a. Section 6621(c) Jurisdiction

Under §6621(c), now repealed but still effective for tax years 1982-1987, an underpayment of tax attributable to one of the tax motivated transactions listed in that statute and the accompanying regulation is subject to an enhanced interest rate. App. 107-08.

Since 1987, the Tax Court has consistently

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[54] *Id.*, at 1379.

held it lacks jurisdiction to make a §6621(c) determination in a partnership-level proceeding because §6621(c) is not a partnership item and not within the scope of a partnership-level proceeding.[55]

The Second and Fourth Circuits have likewise held §6621(c) interest is not a partnership item.[56] In *Field*, the Second Circuit recognized and accepted 20 years of precedent establishing §6621(c) is an affected item with both partnership and partner-level components. The Second Circuit expressly held §6621(c) refund claims are not barred by §7422(h).

Another AMCOR-related §6621(c) decision followed this well-settled approach to affected item jurisdiction – *Weiner*. There the Government did not raise §7422(h) with respect to §6621(c). But the Government raised and the Fifth Circuit addressed §7422(h) with respect to the partner's limitations claim. Had that court considered §7422(h) to be a bar to §6621(c), the Fifth Circuit would have raised

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[55] *N.C.F. Energy*, 89 T.C., at 744-5. See also *Affiliated Equip Leasing II v. C.I.R.*, 97 T.C. 575, 576-78 (1991).

[56] *Field*, 328 F.3d, at 60; *Zfass v. C.I.R.*, 118 F.3d 184, 192 (4th Cir.1997).

§7422(h) *sua sponte*. Instead the court followed established precedent that §6621(c) refund claims are brought at the partner-level and addressed the merits of the claim, holding the IRS improperly imposed §6621(c) against the settled AMCOR partners as a matter of law.

Like *Weiner*, partners in other AMCOR cases (*Keener*, *Prati*, and *Deegan*) and non-AMCOR cases (*McGann* and *Bartimmo*)[57] asserted the IRS misapplied settlements and/or partnership-level decisions and improperly imposed §6621(c) interest. In *Keener*, *Prati*, *McGann*, and *Bartimmo*, the Government asserted later alleged partnership-level, partnership-item determinations were enough to jurisdictionally bar the partners' affected-item, §6621(c) claims – which is a variation of the "low hanging fruit" argument rejected in *Petaluma* and *Jade Trading* but adopted by *LeBlanc*. That approach is not a true jurisdictional determination but a decision on the Government's defense to the merits that is used to foreclose review of the partner-level claim. *Keener* I and *Prati* adopted the

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[57] *McGann v. U.S.*, 76 Fed.Cl. 745 (2007) (jurisdiction) and *McGann v. U.S.*, 81 Fed.Cl. 642 (2008) (merits); *Bartimmo v. U.S.*, 525 F.Supp.2d 879 (S.D.Tex. 2007).

Government's argument and dismissed pursuant to §7422(h). *McGann* and *Bartimmo* rejected the Government's argument and held for the partners on the merits, as the Fifth Circuit had done in *Weiner*.

This §6621(c) affected-item jurisdictional confusion exists in other non-AMCOR cases. In *River City Ranches*, a Hoyt case, the Ninth Circuit held the partnership-item components of §6621(c) are determined at the partnership-level. In *Ertz*, the Tax Court held *River City* barred partner-level jurisdiction over a partner-level, §6621(c) claim.[58] But on appeal *sub nom* in *Keller*,[59] the Ninth Circuit clarified that the partner-level court may and should address §6621(c) based on the application of partnership-level determinations.

In *Keller*, the Ninth Circuit was persuaded that barring partner-level, affected-item claims leaves taxpayers with no possible review of erroneously imposed §6621(c) penalty interest. In *Barlow* the Sixth Circuit similarly held the lack of a *pre*-payment forum (akin to a partnership-level proceeding) to challenge the improper or unsupported imposition of

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[58] *Ertz v. C.I.R.*, 93 T.C.M. (CCH) 696 (2007).

[59] *Keller*, 568 F.3d at 710.

§6621(c) penalty interest does not violate taxpayer Fifth Amendment due process rights because taxpayers have a *post*-payment, refund forum.[60] Because of the limited scope of partnership-level proceedings, *LeBlanc* and other decisions that partake of the "low hanging fruit" to jurisdictionally foreclose affected-item claims have eviscerated that due process safety net and left partners with no forum for review of their affected item claims.

b. *LeBlanc* Is Inconsistent With Second Circuit and Federal Circuit Precedent on the Scope of §7422(h)

LeBlanc is inconsistent with Second Circuit and Federal Circuit §7422(h) precedent. In *Field*, the Second Circuit refused to expand §7422(h) to encompass claims for refund that are *capable* of being attributed to partnership items. The court reasoned §7422(h)'s plain language only bars jurisdiction if the refund itself (not the item which leads to that refund) is attributable to partnership items. The Second Circuit was also persuaded that §7422(h)'s parenthetical reference to §6231(a)(3) strictly limited the jurisdictional

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[60] *Barlow v. C.I.R.*, 301 F.3d 714 (6th Cir. 2002).

bar to defined partnership items.[61]

In *Prochorenko*, the Federal Circuit followed *Monti*, another Second Circuit §7422(h) decision.[62] The *Prochorenko* court recognized that while the partner sought a refund of partnership-related taxes, the claim was "attributable to" §6224(c), an affected item. The Federal Circuit adopted the Second Circuit's observation that "at some level of generality, most refund claims for partnership taxes can be characterized as a refund 'attributable to partnership items,'" and held that construing that phrase so broadly would be contrary to the system of separate treatment of partnership items and nonpartnership items established by Congress in TEFRA.[63] Those courts recognized that where the item sought to be refunded is an affected item, then §7422(h) does not bar the claim even if it is necessary to apply a partnership item determination.

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[61] *Field*, 328 F.3d, at 60.

[62] *Prochorenko*, 243 F.3d, at 1363, citing *Monti*, 223 F.3d, at 82.

[63] *Id.*

c. The Implied Conclusion That the LeBlancs Were Subject to the ACVA Decision Fails to Defer to the IRS's Reasonable Interpretation of Temp. Treas. Reg. §301.6224(c)-3T(a), (b) and Conflicts With the Second Circuit's Affirmation of the IRS's Interpretation

Like all tax settlements, a Form 870-P(AD) is a contract construed under general contract law.[64] But the LeBlancs' Form 870-P(AD), like all Forms 870-P(AD), plainly states on its face that it is a "Consistent Settlement" pursuant to §6224(c). Section 6224(c) creates two types of interdependent settlement agreements that are uniquely governed by statute and regulation as well as contract law.

Under §6224(c)(1), an "original settlement" of partnership items between the IRS and a partner "shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the

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[64] See *Busing v. U.S.*, 47 Fed.Cl. 621, 629-30 (2000), citing *Treaty Pines Inv. Partnership v. U.S.*, 967 F.2d 206 (5th Cir., 1992) and *Goldman v. C.I.R.*, 39 F.3d 402, 405 (2d Cir. 1994) (Form 870-(AD) must be construed using general principles of contract law).

determination of partnership items for such partnership taxable year." If the IRS enters into a §6224(c)(1) original settlement, then under §6224(c)(2) other partners have a right to enter into a "consistent agreement" on "terms for the partnership taxable year which are consistent with those contained in such settlement agreement."

Effective for pre-1997 tax years, Temp. Treas.Reg. §301.6224(c)-3T(b) provided §6224(c) consistent settlements "shall be comprehensive, that is, a settlement may not be limited to selected items." In *Greenberg*, the *IRS* asserted and the Tax Court held the "comprehensive" term applied to original and consistent settlements and meant that both comprehensively settle *all* partnership items for the tax year.[65] In *Cinema '84*, the Second Circuit affirmed the IRS's interpretation of the regulation was reasonable.[66]

That interpretation was consistent with the IRS's official position at the time of LeBlancs'

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[65] *Greenberg Bros. #4 v. C.I.R.*, 111 T.C. 198, 206 (1998), *aff'd sub nom. Cinema '84 v. CI.R.*, 294 F.3d 432 (2nd Cir. 2002).

[66] *Cinema '84*, 294 F.3d, at 439.

settlement.[67] The IRS distinguished between §6224(c) settlements, which must comprehensively settle all partnership items for the tax year, and other settlements such as §7121, Form 906 Closing Agreements, which it recognized could be partial but discouraged due to difficulties in calculating and tracking limitations. In that memorandum, the IRS instructed its litigating personnel that both original settlements and consistent settlements settled *all* partnership items for the tax year and "if a settlement agreement leaves any items to be litigated either at the time it is executed or at the time a request for consistent terms is made, it is our position that the agreement will not be subject to consistent settlement."

Effective October 4, 2001, over a year after the LeBlancs settled with the IRS, Temp.Treas.Reg. §301.6224(c)-3T(b) was replaced by Treas.Reg. §301.6224(c)-3,[68] which recognized partial §6224(c) settlements. But §6224(c)(1) still prohibits partial settlements "except as otherwise provided in such

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[67] IRS Litigation Guideline Memorandum, 1990 WL 1086188, n.2 (IRS LGM), 1990 LGM TL-87 (6/04/90).

[68] 66 FR 50541-1, 50552-3, 2001-2 C.B. 344, 2001 WL 34028604 (October 4, 2001).

agreement." Consequently, the IRS requires promulgated forms to be conspicuously annotated "Partial Agreement" and contain a statement notifying the partner that he remains a party to the partnership-level proceeding for all unsettled partnership items."[69] The LeBlancs' Form 870-P(AD) does not in any way state it was partial.

LeBlanc followed *Schell*, which in turn followed and cited *Keener* I. But *Schell* did not follow *Keener* II, in which the Federal Circuit noted that the AMCOR Forms 870-P(AD) comprehensively settled all of that AMCOR partner's partnership items then before the Tax Court, thereby removing the partner from the partnership-level proceeding.[70]

More importantly, though the scope of §6224(c) settlements is largely controlled by law, the facts of this case are overwhelming and uncontroverted and prove the LeBlancs' settlements were comprehensive. For example, the IRS assessed immediately after the settlements and notified the LeBlancs they

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[69] IRS Non Docketed Service Advice Review, 2002 WL 32167989 (IRS NSAR), 2002 IRS NSAR 20,301 (August 13, 2002).

[70] *Keener* II, at 1360.

could file basis claims at the same time it sent its calculations of the liability that resulted from the settlements.

In the Rule 248(c)(1) notices filed for participating partners, the IRS represented to the Tax Court that pursuant to the AMCOR Form 870-P(AD) settlements the partners' partnership items became nonpartnership items as of the date of the settlement and the settling partners were "no longer a party to the proceeding."

The Government repeated that comprehensive settlement admission in dispositive motions filed with the federal district court for the Southern District of Texas in *Weiner* and *Matthews* and in its appellate brief in *Duffie*. In July and September of 2001, the Government filed two substantively similar cross-motions for summary judgment in *Weiner* (SDTX 00-1297) and *Matthews* (SDTX 00-4131) in which the Government admitted that it was "the IRS's intent that the settlement agreements . . . would represent a comprehensive and final settlement"[71] and

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[71] The LeBlancs request that this Court take judicial notice of page 3 of the United States' Cross-Motion and Supporting Brief for Partial Summary Judgment and Response in Opposition to Plaintiffs' Motion for Partial

"[o]ther partners chose not to settle and remained parties to the partnership-level proceedings in the Tax Court." These judicial admissions are consistent with the Government's representations to the Fifth Circuit in *Duffie* that "[a]s the [partnership-level Tax Court] litigation wore on, some partners entered into individual [Form 870-P(AD)] settlement agreements with the IRS, thereby terminating their status as parties to the litigation. ... *See* I.R.C. §§6226(d)(1)(A), 6231(b)(1)(C). ...."[72]

Finally, as a matter of simple logic these §6224(c) settlements comprehensively settled all partnership items, including the characterization of the partnership-items because a sham allegation is inconsistent with the amount of the adjustment. *LeBlanc* and *Schell* split with the Eleventh Circuit and the

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Summary Judgment on Statute of Limitations for 1984 filed with the Southern District of Texas in *Matthews* (document 29) on September 27, 2001.

[72] The LeBlancs request that this Court take judicial notice of page 7 of the Brief for the Appellee United States of America filed with the Fifth Circuit in *Duffie* on September 14, 2009.

Second Circuit on this issue. In *Fickling*,[73] the Eleventh Circuit refused to split the characterization of a tax item from the adjustment itself. There the taxpayer later attempted to inconsistently recharacterize a settled item as a sham after the IRS had agreed to allow over half of the item. In *Callaway*, the Second Circuit established that a partnership-item determination is conclusive for all purposes and refused to allow the widow of a partner to treat partnership items inconsistently than they had been determined.[74] Also, once a partnership item converts to a nonpartnership item, there is no "partnership item" character left – only the character of the now converted nonpartnership item exists.

If the Court finds in favor of jurisdiction, then summary judgment should be granted on the partial settlement issue. The LeBlancs produced overwhelming evidence that the settlements were comprehensive. The Government, the moving party, did not respond to and wholly failed to rebut that evidence. The Government should also be

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[73] *Fickling v. U.S.*, 507 F.3d 1302 (11th Cir. 2007).

[74] *Callaway, supra.*

bound to its admissions and representations to various courts respecting the comprehensive nature of the settlements.

d. *Arguendo*, If the Disallowed Deductions Were Attributable to Transactions That Lacked Economic Substance, the Trial Court's Determination of Zero Basis Was Wrong as a Matter of Law and Conflicts With Supreme Court and Other Circuit Precedent.

In LeBlanc the Federal Circuit stated "the refund claim was necessarily based on the assertion that the partnership's transactions were not shams." App. 5-6. This conclusion inherently relies on misapplication of this Court's treatment of transactions that "lack economic substance" and a long, convoluted, and often misused application of the term "sham." The LeBlancs' refund claim does not in any way rely on assertion that the agreed disallowed losses were not shams or that they had economic substance. To the contrary, if the agreed disallowed losses lacked economic substance the LeBlanc's refund claim should be granted.

ACVA filed returns for tax years 1986-

2000.[75] The IRS disputed only the 1986 return. For *all other years* the IRS accepted ACVA's deductions and income as filed and reported. Even as to 1986, the IRS agreed that about half of the ACVA partnership item deductions were correct "as reported." App. 116.

In the end, the issue here is very straight forward: what effect, if any, did the agreed partial disallowance of partnership expenses and indebtedness (even assuming it was for lack of economic substance in 1986) have on the ultimate computation of the LeBlancs' tax basis in their ACVA partnership interest when they abandoned that interest in 1999. The core issue is simple: a partnership transaction either has economic substance for *all* tax purposes or it lacks economic substance for *all* tax purposes.[76] A partnership transaction

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[75] Tax year 2000 does not apply to the LeBlancs because they abandoned their ACVA partnership interest in 1999.

[76] *ACM Partnership v. C.I.R.*, 73 T.C.M. (CCH) 2189, 2217 (1997), *aff'd* in relevant part, 157 F.3d 231, 252 and n. 42 (3rd Cir., 1998)(transactions without economic substance are not given economic effect); *Rink v. C.I.R.*, 47 F.3d 168, 172 (6th Cir. 1995) ("Accordingly, if the court determines that the transaction is a sham, the entire transaction is

cannot have economic substance for *some* tax purposes.

The LeBlancs' Form 870-P(AD) stated no reason for the partial disallowance and never referenced the character of any partnership transactions. App. 118-120. Later, in the ACVA partnership-level decision, the IRS and TMP agreed (i) that 49% of ACVA's 1986 partnership item deductions would be disallowed and that those adjustments were "attributable to transactions that lacked economic substance" and (ii) that about 81.2% of the partnership's indebtedness lacked economic substance. App. 116-117.

The implicit assumption in the *LeBlanc* appellate opinion is that the disallowed deductions have economic substance for purposes of reducing the LeBlancs' tax basis and that ACVA's indebtedness has economic substance to first increase and then decrease the LeBlancs' outside basis because it was reduced in post-1986 tax years, both in direct conflict as treating them as transactions that lack economic substance or that are "shams". This essentially argues that the disallowed

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disallowed for federal income tax purposes."). *ACM* and *Rink* are consistent with *Gregory v. Helvering*, 293 U.S. 465 (1935).

portion of the debt must be given economic substance contrary to the ACVA decision, but only for *some* tax purposes, and only those benefitting the IRS. This is nonsense.

A transaction devoid of economic substance cannot reduce basis. To adjust basis under §705(a)(2)(b) an expenditure must (i) actually occur, and (ii) have economic substance. By contrast, an expenditure that does have true economic substance may not be tax deductible but does still reduce basis.[77] For example, payments by a partnership made on a car for a partner's child or a nondeductible political contribution are *not* deductible but they obviously *do* have economic substance (funds were paid) and *do* adjust basis because they (i) had economic substance, (ii) do not quality for tax deductions, and (iii) are not capital expenditures (they do not convert cash to another partnership capital asset).[78]

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[77] §705(a)(2)(b) (basis is reduced for expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account ....).

[78] It is also well established that not all disallowed deductions result in a reduction in basis. For example, the taxpayer in *Frick v. C.I.R.*, 31 T.C.M. (CCH) 286 (1972), claimed a 1965 partnership loss of $1,400.00

In contrast, if a partnership sought to deduct an expenditure paid with a check returned for insufficient funds, then that deduction should be disallowed because, while an event occurred (to the extent that a check was actually written), it *lacked economic substance.*

Here the appellate court erroneously concluded that although ACVA's 1986 disallowed partnership expenses and liabilities have *no* economic substance, they *must* be included in LeBlanc's 1999 basis computation. Under that analysis, in the "insufficient funds" example that check, while not deductible and having no economic substance, *would nevertheless* reduce the partners' tax bases in their partnership. That is nonsense. If a reported expense or liability had no economic substance, how can it either increase or decrease a partner's basis? The *LeBlanc*

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and a 1966 partnership loss of $6,900.00. The Tax Court allowed a loss of only $696.44 for 1966. Subsequently, the Tax Court concluded "the petitioner must reduce his basis . . . by $2,096.44, the total amount of partnership losses *he was allowed to deduct for 1965 and 1966.*" *Frick v. C.I.R.*, 35 T.C.M. (CCH) 1572, 1577 (1976). [Emphasis added.] The disallowed portion of the 1966 deduction did *not* reduce basis.

appellate opinion leads to absurd results and should be rejected.

The "insufficient funds" scenario is analogous to what the IRS asserted happened in the AMCOR cases.[79] The IRS asserted the AMCOR partnerships wrote checks to farmers based on funds available from loans by those same farmers.[80] The Tax Court decisions agreed that most of that indebtedness lacked economic substance. The purported payments to the farmers with the nonexistent proceeds of those loans were not payments for federal tax purposes, were agreed to lack economic substance, and cannot reduce the partners' bases in ACVA. The loans lacking economic substance cannot support the related farm expenses purportedly paid by those checks. There were no funds available to support those alleged payments because the loan of those funds lacked economic substance. It was a mere check swap.

The CFC treated both the disallowed farming expenses and debt as having economic

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[79] *Schrott v C.I.R.*, T.C.Memo. 1989-346 ("Courts typically disregard check swaps . . . .").

[80] *Crop Associates-1986 v. C.I.R.*, 80 T.C.M. (CCH) 56, 60 (2000).

substance, but only for purposes of computing basis. The Government does not dispute that when those items are not included, the LeBlancs had a substantial 1999 ending outside basis.

It is also instructive that in the ACVA decision the IRS and TMP agreed that "liabilities in the amount of $23,216.748 lack economic substance." App. 117. That provision could not impose additional tax and was completely irrelevant to the agreed disallowance of partnership item deductions on which the IRS based the resulting assessments.[81] As a matter of law that provision could serve only one purpose: to protect the partners from the IRS double-dipping by barring the IRS from treating the later reductions in that debt as reductions in basis, or even as taxable income if the debt is later forgiven or compromised, or simply written off on the partnership's books.

Including an explicit provision that the disallowed expense deductions were attributable to transactions which lacked economic substance and that the debt upon

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[81] The economic substance of the *liabilities* was utterly irrelevant to the 1986 assessments arising from the Forms 870-P(AD) and ACVA decision.

which they were based lacked economic substance ensured that characterization was unambiguous and those expenses and debt could not later be deemed to *have* economic substance for some tax purposes and *lack* economic substance for other tax purposes, precisely what the Claims Court erroneously did below and what the LeBlanc appellate court implicitly did.

The IRS fully understood the consequences of this protective provision when it notified the partners they could file capital loss claims based on their outside basis when they sold their partnership interests.

The Government now seeks to improperly subvert this agreed protective provision, the intent of the IRS and TMP, and the agreed terms of the ACVA decision. If the Government's disingenuous argument is given any credence, then at a minimum this case should be remanded for a trial on the intent of the IRS and TMP, especially as to the meaning and purpose of the agreement that "liabilities in the amount of $23,216.748 lack economic substance."

Tax settlements and agreed decisions are

controlled by general contract principles.[82] Contract principles mandate that the intent of the parties controls, any ambiguity is interpreted against the drafter, and every provision must be given meaning. It is undisputed that the IRS drafted and submitted the adhesion ACVA agreed decision which the limited partners could only take-or-leave.

CONCLUSION

Review should be granted to address these fundamental jurisdiction issues and resolve the Circuit splits and disparate treatment of similarly situated taxpayers in affected item litigation.

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[82] *Gingerich v. U.S.*, 77 Fed.Cl. 231, 240 (2007), citing *Treaty Pines*, 967 F.2d, at 211.

Respectfully submitted.

Thomas E. Redding
Counsel of Record
Teresa J. Womack
Sallie W. Gladney
Redding & Associates, P.C.
2914 West T.C. Jester
Houston, TX 77018
(713) 965-9244
Counsel for Petitioners

MAY 2011

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NOTE: This disposition is nonprecedential.

United States Court of Appeals for the Federal Circuit

ELWOOD J. LEBLANC, JR. and JANICE L. LEBLANC,
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

2010-5073

Appeal from the United States Court of Federal Claims in Case No. 05-CV-743, Judge Francis M. Allegra.

Decided: February 7, 2011

THOMAS E. REDDING, Redding & Associates, P.C., of Houston, Texas, argued for plaintiffs-

appellants. With him on the brief were TERESA J. WOMACK and SALLIE W. GLADNEY.

DEBORAH K. SNYDER, Attorney, Commercial Litigation Branch, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were JOHN A. DICICCO, Acting Assistant Attorney General, and BRUCE R. ELLISEN, Attorney.

Before RADER, *Chief Judge*, GAJARSA and PROST, *Circuit Judges*.

RADER, *Chief Judge*.

On summary judgment, the United States Court of Federal Claims determined that Elwood J. LeBlanc, Jr. and Janice L. LeBlanc had no entitlement to a refund for federal income tax paid in connection with their investments in a partnership. *LeBlanc v. United States*, 90 Fed. Cl. 186, 195-96, 203 (Fed. Cl. 2009). The trial court also refused to dismiss the claim for lack of jurisdiction. *Id.* Because the trial court lacked subject matter jurisdiction over this refund claim, this court reverses the jurisdictional finding and remands the case with instructions to dismiss.

I

The LeBlancs became limited partners in Agri-Cal Venture Associates ("ACVA") in 1986. On its partnership tax return for tax year 1986, ACVA

claimed a net loss of approximately $34 million. Based on their distributive share of these losses, the LeBlancs reported a loss deduction of $69,380 on their 1986 joint federal income tax return. The Internal Revenue Service ("IRS") disallowed approximately $33 million of the claimed losses, in part because it found that "[t]he partnership's activities constituted a series of sham transactions lacking economic substance." J.A. 97-101. In response, some of the partners filed a petition in the United States Tax Court seeking readjustment of partnership items.

In 1999, the LeBlancs abandoned their partnership interest in ACVA. Then in 2000, while the partnership-level proceeding before the Tax Court was still pending, they settled their 1986 income tax liability with the IRS. Under that partner-specific settlement agreement, the IRS allowed them to report about half of the previously disallowed losses.

The Tax Court issued its decision in the partnership-level proceeding in 2001, reducing ACVA's net loss in tax year 1986 by approximately $16 million based on its finding that the partnership's activities "lacked economic substance." J.A. 179-80.

In 2002, the LeBlancs filed a refund claim for their 1999 tax year. They claimed an ordinary loss of $34,084 and sought a refund of $8,789 "[t]o reflect loss on partner-ship interest abandonment"

for ACVA. J.A. 192-93, 199. The IRS disallowed their refund claim. The LeBlancs filed this refund suit in the U.S. Court of Federal Claims.

In their amended complaint, the LeBlancs alleged that "[a]s an indirect consequence of the settlement, there was a substantial basis in the partnership interest and a resulting loss upon the abandonment of the partnership, which loss is the basis of this claim for refund." J.A. 242. The Government moved to dismiss the complaint for lack of subject matter jurisdiction or, in the alternative, for summary judgment that the LeBlancs' basis in their partnership interest was zero at the time of the alleged abandonment, precluding the claimed loss. The trial court found that it had jurisdiction but granted the Government's motion for summary judgment. This court has jurisdiction under 28 U.S.C. § 1295(a)(3).

II

This court reviews without deference the trial court's determination that it had subject matter jurisdiction. *Wilson v. United States*, 405 F.3d 1002, 1008 (Fed. Cir. 2005).

In *Schell v. United States*, 589 F.3d 1378 (Fed. Cir. 2009), a decision that issued after the trial court had already decided the instant case, this court was presented with a nearly identical set of facts and concluded that the trial court lacked jurisdiction. Like the LeBlancs, the *Schell*

taxpayers invested in partnerships that reported losses and then reported their pro rata share of the loss on their tax returns. *Id.* at 1380. The IRS found that the partnerships' activities were sham transactions, lacking economic substance, and disallowed the claimed losses. *Id.* While partnership-level proceedings challenging these findings were pending in the Tax Court, the taxpayers in *Schell* entered into partner-specific settlement agreements with the IRS, allowing them to report approximately half of the previously disallowed losses. *Id.* The Tax Court later found that the partnerships' transactions "lacked economic substance." *Id.*

After the partnerships at issue terminated, the *Schell* taxpayers filed a refund claim, contending that "as a direct consequence of the settlement . . . there was a substantial basis in the partnership interest and a resulting loss upon the dissolution and termination of the partnership, which loss is the basis of this claim for refund." *Id.* The IRS rejected their refund claim, and the taxpayers in *Schell* filed a complaint at the Court of Federal Claims. *Id.* The Court of Federal Claims dismissed the complaint for lack of jurisdiction, and this court affirmed on appeal. *Id.* at 1380-81, 1384.

As this court explained in *Schell*, "a sham transaction, devoid of economic substance, cannot be the basis for a deductible loss." *Id.* at 1382. Consequently, the refund claim was necessarily

based on the assertion that the partnerships' transactions were not shams. Because the question as to whether a partnership transaction was a sham is a partnership item, *Keener v. United States*, 551 F.3d 1358, 1365 (Fed. Cir. 2009), such refund claims are attributable to a partnership item. Under the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), the Court of Federal Claims lacks jurisdiction to hear partner refund claims where the refund is "attributable to partnership items." I.R.C. § 7422(h). Accordingly, the Court of Federal Claims correctly found that it lacked jurisdiction over the refund claim in *Schell*. *Id.*

The same reasoning applies to the LeBlancs. Their refund claim rests on the assertion that ACVA's transactions were not shams and thus is attributable to a partnership item. Because the facts in this case are indistinguishable from the facts in *Schell*, this court reverses the trial court's jurisdictional finding and remands with instructions to dismiss for lack of subject matter jurisdiction.

REVERSED AND REMANDED

In The United States Court of Federal Claims

No. 05-743T

(Filed: December 4, 2009)

ELWOOD J. LEBLANC, JR. AND JANICE L. LEBLANC,

Plaintiffs,

v.

THE UNITED STATES,

Defendant.

* Federal income tax; Summary judgment; Abandonment of partnership interest; Section 165 of the Internal Revenue Code – loss deduction; TEFRA partnership provisions; Jurisdiction – whether abandonment loss deduction was proper is "affected item" over which jurisdiction lies; Adjusted basis of partnership interest; Section 705 of the Internal Revenue Code; Treatment of distributed losses; Partnership interest had zero basis; Loss deduction properly disallowed.

OPINION

Thomas E. Redding, Redding & Associates, P.C., Houston, TX, for plaintiffs.

Bart D. Jeffress, United States Department of Justice, Washington, D.C., with whom was Acting

Assistant Attorney General *John A. DiCicco*, for defendant.

ALLEGRA, Judge:

Plaintiffs were limited partners in an "agricultural" partnership that generated large "farming" expense deductions for its partners in its first year of operation. After an audit and in settlement of a succeeding lawsuit, the partnership agreed to the disallowance of a portion of those deductions as, *inter alia*, lacking in economic substance. Plaintiffs essentially agreed to the same adjustments in a separate settlement with the Internal Revenue Service (IRS). A dozen years later, plaintiffs abandoned their partnership interest and sought to deduct a loss roughly equivalent to the amount of their share of the previously-disallowed farming expenses. This equivalence was no more than coincidence, plaintiffs assert, claiming that their loss deduction was impelled by the relevant provisions of the Internal Revenue Code. Not so, defendant remonstrates, asserting, *inter alia*, that plaintiffs' deduction stemmed from a gross misapplication of the Code's rules for calculating the adjusted basis of their partnership interest. Who is right? That is the subject of defendant's pending motion for summary judgment.

I. BACKGROUND

Plaintiffs, Elwood and Janice LeBlanc, held a limited partnership interest in Agri-Cal Venture Associates (ACVA) from 1986 through 1998. Plaintiffs initially contributed $26,000 to the partnership, while assuming $41,600 (or some lesser amount) in partnership liabilities. On its partnership tax return for tax year 1986, ACVA claimed a net loss of approximately $34 million. Approximately $32 million of those losses arose from reported farming expenses, with the remainder attributable to miscellaneous expenses and pass-through loss deductions from two other partnerships. Based on their distributive share of these losses, plaintiffs claimed a corresponding pass-through loss deduction on their 1986 return of $69,380.

On March 14, 1990, the IRS issued ACVA a Notice of Final Partnership Administrative Adjustment (FPAA) disallowing approximately $33 million of the claimed losses for 1986 – specifically, $32,181,001 of the farming expenses claimed on Schedule F and other deductions in the amount of $634,885. By way of explanation, the FPAA asserted that:

1. The partnership's activities constituted a series of sham transactions lacking economic substance.

2. The partnership did not actively engage in the trade or business of farming during the taxable period.

3. The partnership did not pay or incur any bona fide trade or business expenses during the taxable period, or if the partnership did pay or incur any expenses during the taxable period, it has not been established that they were ordinary and necessary trade or business expenses currently deductible under section 162 of the Internal Revenue Code (IRC) and the Regulations thereunder.

As a result of these readjustments, the FPAA determined that the tax preference item of qualified investment expenses should be $1,309,608 in lieu of the $31,738,390 reported on the partnership tax return – a reduction of $30,428,782.

On June 13, 1990, ACVA filed a petition in the United States Tax Court seeking the readjustment of various partnership items under section 6226 of the Code.[1] The petition contested the FPAA findings, claiming that the IRS had erred in: (i) disallowing the partnership's 1986 deductions; (ii) determining that the partnership's activities

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[1] Except as otherwise indicated, all references herein are to the Internal Revenue Code of 1986 (26 U.S.C.), as amended, and in effect during the years at issue.

constituted sham transactions lacking economic substance; and (iii) determining that the partnership had not incurred or paid bona fide ordinary and necessary business or trade expenses. The IRS issued no additional FPAAs to ACVA through 1998. Plaintiffs abandoned their partnership interest in ACVA in 1999. At the time of the abandonment, plaintiffs' share of ACVA's liabilities had been reduced to zero.

On May 5, 2000, while ACVA's petition for readjustment was still pending before the Tax Court, plaintiffs sent the IRS an executed Form 870-P(AD), offering to settle the 1986 partnership items. On June 16, 2000, an authorized official of the IRS signed the form 870- P(AD), signifying the agency's acceptance of the settlement offer. Under the terms of the settlement, the parties agreed to the disallowance of approximately $17 million of the partnership losses originally reported, decreasing ACVA's 1986 net loss by over 50 percent. The settlement agreement did not address other aspects of the FPAA's findings, such as whether ACVA's activities constituted sham transactions or if the reported partnership liabilities were *bona fide*. Pursuant to the settlement, on March 5, 2001, the IRS sent plaintiffs a notice of adjustment reflecting a reduction of $35,239 in their 1986 pass-through loss and a subsequent increase of $14,598 in tax liability. On March 26, 2001, the IRS sent plaintiffs a notice requesting payment of the

$14,598 tax deficiency, plus $47,368.12 in interest; plaintiffs thereafter paid these amounts.

While plaintiffs were in the midst of settling with the IRS, the aforementioned Tax Court proceeding continued. On July 19, 2001, the Tax Court granted a motion for entry of decision pursuant to Rule 248(b) of the Tax Court Rules of Practice and Procedure and issued a decision adopting a settlement agreement between ACVA and the Commissioner of Internal Revenue. That decision made the following adjustments for the partnership's 1986 taxable year:

ADJUSTMENT TO ORDINARY INCOME:

Partnership Item	As Reported	As Determined
Farming Expense Schedule F	$32,181,001.00	$16,081,646.00
Other Deductions	$ 634,885.00	$ 634,885.00
Capital Contributed	$12,660,000.00	$12,660,000.00
Liabilities	$27,607,878.00	$ 4,391,130.00

TAX PREFERENCE ITEMS:

Partnership Item	As Reported	As Determined
Qualified Investment Expense	$30,428,782.00	$ 5,781,469.00

By way of explanation, the decision indicated "[t]hat the foregoing adjustments to partnership income and expense are attributable to

transactions which lacked economic substance, as described in former I.R.C. § 6621(c)(3)(A)(v)," and "[t]hat liabilities in the amount of $23,216,748 lack economic substance."[2]

On May 24, 2002, plaintiffs filed a tax refund claim for 1999. They claimed a loss of $34,084, owing to the abandonment of their partnership interest, and a resulting tax refund of $8,789, due to their claimed basis in ACVA at the termination of the partnership. On July 10, 2003, the IRS disallowed plaintiffs' refund claim based on its determination that the ACVA partnership was a "sham[] and had no economic substance."

Plaintiffs filed a refund suit in this court on July 11, 2005, and an amended complaint on November 7, 2008. Their amended complaint

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[2] The Tax Court decision allowed ACVA to deduct approximately 50 percent of its claimed farming expenses and one hundred percent of its other deductions, correspondingly reducing the deductions allowed to the partners. While the FPAA did not specifically address the issue of liabilities, the Tax Court disallowed eighty-four percent of the partnership's claimed short-term mortgages, notes, and bonds. The Tax Court's readjustment presumably required ACVA's partners to recalculate their assumed share of the partnership's liabilities and reduce their 1986 basis, accordingly, pursuant to sections 752(b) and 705(a)(2) of the Code. The Tax Court severely reduced ACVA's tax preference item of qualified investment expenses to reflect the aforementioned readjustments.

averred that, "[a]s an indirect consequence of the settlement [with the IRS], there was a substantial basis in the [ACVA] partnership interest and a resulting loss upon the abandonment of the partnership, which loss is the basis of this claim for refund." On February 18, 2009, defendant filed a motion for summary judgment, contending that this court lacks subject matter jurisdiction over this suit, or, in the alternative, that plaintiffs had no basis upon which to claim an abandonment loss. Plaintiffs filed their response on March 16, 2009, and defendant filed its reply on May 15, 2009. Oral argument was held on July 8, 2009.

II. DISCUSSION

Summary judgment is appropriate when there is no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law. RCFC 56; *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986); *Clearmeadow Invs., LLC v. United States*, 87 Fed. Cl. 509, 518 (2009). Disputes over facts that are not outcome-determinative will not preclude the entry of summary judgment. *Anderson*, 477 U.S. at 248. However, summary judgment will not be granted if "the dispute about a material fact is 'genuine,' that is, if the evidence is such that a reasonable [trier of fact] could return a verdict for the nonmoving party." *Id.*; *see also Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475

U.S. 574, 587 (1986); *Clearmeadow*, 87 Fed. Cl. at 518.

When reaching a summary judgment determination, the court's function is not to weigh the evidence, but to "determine whether there is a genuine issue for trial." *Anderson*, 477 U.S. at 249; *see also Agosto v. INS*, 436 U.S. 748, 756 (1978) ("[A] [trial] court generally cannot grant summary judgment based on its assessment of the credibility of the evidence presented."); *Am. Ins. Co. v. United States*, 62 Fed. Cl. 151, 154 (2004). The court must determine whether the evidence reflects a disagreement sufficient to require fact finding or is so one-sided that one party must prevail as a matter of law. *Anderson*, 477 U.S. at 250-52; *Lockheed Martin Corp. v. United States*, 70 Fed. Cl. 745, 748-49 (2006). All facts must be construed, and all inferences drawn from the evidence must be viewed, in the light most favorable to the party opposing the motion. *Matsushita*, 475 U.S. at 587-88 (citing *United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1962)); see also *Lockheed Martin*, 70 Fed. Cl. at 749; *L.P. Consulting Group, Inc. v. United States*, 66 Fed. Cl. 238, 240 (2005).

A.

Plaintiffs claim an ordinary loss deduction, pursuant to section 165(a) of the Code, based upon the abandonment of their interest in the ACVA partnership. At the outset, the court faces a

challenge to its jurisdiction, the resolution of which necessarily requires it to delve into not only the basic provisions concerning the deductibility of losses, but also the partnership audit provisions of the Code.

1.

We begin with the general rules governing the deductibility of abandonment losses. Section 165(a) of the Code allows, as a deduction from gross income, "any loss sustained during the taxable year and not compensated for by insurance or otherwise." 26 U.S.C. § 165(a). A deductible loss under this provision may arise from the abandonment of property, "defined as a permanent disposition, not sold, never to be used again and not retrieved for sale, exchange, or other disposition." *Kraft, Inc. v. United States*, 30 Fed. Cl. 739, 785 (1994); *see also* Treas. Reg. § 1.165-2; *Corra Res. Ltd. v. Comm'r of Internal Revenue*, 945 F.2d 224, 226 (7th Cir. 1991); *Gulf Oil Corp. v. Comm'r of Internal Revenue*, 914 F.2d 396, 402 (3d Cir. 1990).[3] Under section 165(b) of the Code, an abandonment loss may be deducted in an amount

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[3] Some express manifestation of abandonment is required when the asset is an intangible property interest, such as a partnership interest. See *Milton v. Comm'r of Internal Revenue*, 2009 WL 3460727, at *3 (U.S. T.C. Oct. 28, 2009); *Citron v. Comm'r of Internal Revenue*, 97 T.C. 200, 209-10 (1991).

corresponding to the taxpayer's adjusted basis in the subject property, as determined under section 1011 of the Code. *See Hartford Elec. Light Co. v. United States*, 204 Ct. Cl. 875, 881 (1974); *Parmelee Transp. Co. v. United States*, 351 F.2d 619, 623 (Ct. Cl. 1965).

Once an abandonment is established, the availability of a deduction therefor is qualified by section 165(c), which provides –

> **(c) Limitation on losses of individuals.** – In the case of an individual, the deduction under subsection (a) shall be limited to –
>
> (1) losses incurred in a trade or business;
>
> (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; . . .

26 U.S.C. § 165(c); *see also* Treas. Reg. § 1.165-1(e). Section 183(a) of the Code reinforces the "for profit" requirement in section 165(c)(2) by requiring, with exceptions not herein relevant, that "[i]n the case of an activity engaged in by an individual . . . , if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter . . . ." 26 U.S.C. § 183(a); 7 Mertens Law of Federal Income Tax

(hereinafter "Mertens") § 28:64 (2009).[4] For purposes of these provisions, "profit" means economic profit independent of tax savings. See *Kirchman v. Comm'r of Internal Revenue*, 862 F.2d 1486, 1491 (11th Cir. 1989) ("Naturally, the profit or economic motivation cannot be merely tax benefits."); *see also Holmes v. Comm'r of Internal Revenue*, 184 F.3d 536, 543 (6th Cir. 1999). In

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[4] As noted by one commentator, "[w]hen determining whether a taxpayer has engaged in an activity for profit and whether a taxpayer may avoid the Section 183 limitation on the amount of deductible losses, a facts and circumstances test is applicable." Mertens, *supra*, at § 28:1 (citing Treas. Reg. § 1.183-2(b)). The Treasury Regulations provide a nonexclusive list of the factors that may be considered in resolving this profit motive issue, including:

> (1) the manner in which the taxpayer carries on the activity;
> (2) the expertise of the taxpayer or advisors;
> (3) the time and effort expended by the taxpayer in carrying on the activities;
> (4) an expectation that assets used in the activity may appreciate in value;
> (5) the success of the taxpayer in carrying on other similar or dissimilar activities;
> (6) the taxpayer's history of income or losses with respect to the activity;
> (7) the amount of occasional profits, if any; and
> (8) the financial status of the taxpayer.

Treas. Reg. § 1.183-2(b); see also *Johnson v. United States*, 32 Fed. Cl. 709, 715 (1995), *aff'd sub nom., Drobny v. United States*, 86 F.3d 1174 (Fed. Cir. 1996).

addition, the Treasury Regulations under section 165 provide that "[o]nly a bona fide loss is allowable," adding, in terms familiar to tax lawyers, that "[s]ubstance and not mere form shall govern in determining a deductible loss." Treas. Reg. §1.165-1(b); *see also Cottage Sav. Ass'n v. Comm'r of Internal Revenue*, 499 U.S. 554, 567 (1991); *Henley v. United States*, 396 F.2d 956, 962-63 (Ct. Cl. 1968). The taxpayer generally bears the burden of demonstrating that the requisite profit motive exists. See *INDOPCO, Inc. v. Comm'r of Internal Revenue*, 503 U.S. 79, 84 (1992); *see also New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934).

So does this court have jurisdiction to consider the deductibility, under section 165, of a loss attributable to the abandonment of a partnership interest? As a further prelude to answering this question, this court is yet again obliged to explore "the wilds of the TEFRA partnership provisions." *Keener v. United States*, 76 Fed. Cl. 455, 457 (2007), aff'd, 551 F.3d 1358 (Fed. Cir. 2009), *cert. denied*, 120 S. Ct. 152 (2009).

"Although they file information returns under section 701 of the Code," this court has observed, "partnerships, as such, are not subject to federal income taxes. Instead, under section 702 of the Code, they are conduit entities, such that items of partnership income, deductions, credits, and losses are allocated among the partners for inclusion in

their respective returns." *Grapevine Imports Ltd. v. United States*, 71 Fed. Cl. 324, 326 (2006); *see also United States v. Basye*, 410 U.S. 441, 448 (1973); *Keener v. United States*, 551 F.3d 1358, 1361 (Fed. Cir.), *cert. denied*, 130 S. Ct. 152 (2009) (*Keener II*). Prior to 1983, the examination of a partnership for federal tax purposes was a tedious affair, essentially encompassing an audit of each partner. If the matter proceeded to litigation, multiple proceedings in different venues involving the same partnership were common, sometimes producing a welter of inconsistent results.[5] Seeking to remedy this situation, Congress passed the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 648-71 (TEFRA). TEFRA "created a single unified procedure for determining the tax treatment of all partnership items at the partnership level, rather than separately at the partner level." *In re Crowell*, 305 F.3d 474, 478 (6th Cir. 2002) (citing H.R. Conf. Rep. No. 97-760, at 599-600 (1982)); *see also Keener II*, 551 F.3d at 1361. Under this new regime, partnerships are required to file informational returns reflecting the distributive shares of income, gains, deductions, and credits attributable

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[5] *See Bassing v. United States*, 563 5 F.3d 1280, 1282-83 (Fed. Cir. 2009); *Grapevine Imports*, 71 Fed. Cl. at 326-27; *see also* 2 Arthur B. Willis, John S. Pennell & Philip F. Postlewaite, Partnership Taxation (hereinafter "Willis") ¶ 20.01[2] (6th ed. 2009) (describing the pre-1983 procedures).

to their partners, while individual partners are responsible for reporting their *pro rata* share of tax on their income tax returns. *See* 26 U.S.C. § 701; *Weiner v. United States*, 389 F.3d 152, 154 (5th Cir. 2004), *cert. denied*, 544 U.S. 1050 (2005).

"The threshold determination whether, *vel non*, an item is a 'partnership item' governs how the TEFRA procedures apply." *Keener*, 76 Fed. Cl. at 458. Under this taxonomy, the treatment of partnership items is resolved at the partnership level, in a unified partnership proceeding.[6] While the phrase "partnership item" is variously defined by TEFRA, the concept generally encompasses items "required to be taken into account for the partnership's taxable year" and those "more appropriately determined at the partnership level than at the partner level." 26 U.S.C. §6231(a)(3). Such items, more specifically, include the income, gains, losses, deductions and credits of a partnership, as well as the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of these income tax ingredients, among which are "whether partnership activities have been engaged in with the intent to make a profit for purposes of section

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[6] *See* 26 U.S.C. § 6221; *see also id.* at §§ 6211(c), 6230(a)(1); *Bassing*, 563 F.3d at 1283; *AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. United States*, 481 F.3d 1351, 1355 (Fed. Cir. 2007).

183." Treas. Reg. §§301.6231(a)(3)-1(a), 301.6231(a)(3)-1(b). Nonpartnership items are those that are not partnership items, 26 U.S.C. §6231(a)(4), the tax treatment of which is resolved at the individual partner level, using, *inter alia*, the normal deficiency procedures of the Code. *Id.* at §§ 6211, 6212, 6230(a)(2); see also *Keener II*, 551 F.3d at 1361-62. Finally, at the "interstices between partnership and nonpartnership items lie . . . so-called 'affected items,' hybrids of a sort," *Keener*, 76 Fed. Cl. at 458, defined as "any item to the extent such item is affected by a partnership item." 26 U.S.C. § 6231(a)(5); see also *Gingerich v. United States*, 77 Fed. Cl. 231, 241 (2007). Under TEFRA, affected items have two prongs – one is a partnership issue, the other a nonpartnership issue, with the former affecting the latter. *See Keener*, 76 Fed. Cl. at 460; Willis, *supra*, at ¶ 20.02[4][c].

If the IRS decides to adjust a "partnership item" reflected on the partnership's return, it must notify the individual partners of the adjustment through a FPAA. 26 U.S.C. § 6223; *Kaplan v. United States*, 133 F.3d 469, 471 (7th Cir. 1998). Various partners with significant roles or interests in the partnership have the right to file a petition for readjustment of the partnership items in the Tax Court, this court, or the United States district courts. *See* 26 U.S.C. §§ 6226(a), 6226(b)(1); *see also Monahan v. Comm'r of Internal Revenue*, 321

F.3d 1063, 1065 (11th Cir. 2003). If a partner's tax liability might be affected by the outcome of the litigation of partnership items, that partner may participate fully in the proceedings. 26 U.S.C. §§6224(a), 6224(c). The IRS may assess additional tax liability against individual partners within one year of the final conclusion of the partnership's tax determination. *Id.* at § 6229(d). In theory, the partner may contest the tax liability by paying the assessment and filing a refund action in this court. However, with exceptions not relevant herein, "[n]o action may be brought [in this court] for a refund attributable to partnership items (as defined in section 6231(a)(3))." *Id.* at § 7422(h); *see also Bassing*, 563 F.3d at 1282; *Prochorenko v. United States*, 243 F.3d 1359, 1362-63 (Fed. Cir. 2001).

To the extent a partner settles his partnership tax liability with the IRS, the partner no longer participates in the partnership level litigation, and instead is bound by the terms of the settlement agreement. 26 U.S.C. §§ 6224(c)(1), 6226(d), 6228(a)(4)(B). Partnership items convert to nonpartnership items when the IRS enters into a settlement agreement with the partner with respect to such items. *Id.* at § 6231(b)(1)(C). If a partner files an action for a refund attributable to partnership items, but those items have been converted through a settlement agreement, the jurisdictional bar of section 7422(h) no longer applies. *See Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995); *Prati v. United States*, 81

Fed. Cl. 422, 429 (2008); *see also Keener*, 76 Fed. Cl. at 459.

B.

Within this TEFRA framework, defendant argues that this court lacks subject matter jurisdiction to resolve plaintiffs' entitlement to their claimed abandonment deduction because that resolution requires determination of a partnership item – whether the partnership acted with a profit motive or instead conducted transactions that were shams – which TEFRA prohibits plaintiffs from litigating in this partner-level suit. Plaintiffs, for their part, readily acknowledge that whether a partnership transaction has economic substance is a partnership item that must be resolved in a partnership proceeding. They contend, however, that this issue already has been resolved here, either in their earlier settlement with the IRS or the Tax Court's subsequent decision in the partnership-level proceeding. These events, they asseverate, pave the way for this court to resolve their entitlement to the claimed loss deduction.

1.

As both parties agree, for plaintiffs to obtain a section 165 loss deduction, they must show that the partnership engaged in activities with an intent to generate a profit. There are several reasons for this, among them, that no part of a partner's outside basis may be attributable to a

disregarded partnership (or disregarded transaction thereof). *See Petaluma FX Partners, LLC v. Comm'r of Internal Revenue*, 2008 WL 4682543, at *10-11 (U.S. T.C. Oct. 23, 2008); *Napoliello v. Comm'r of Internal Revenue*, 97 T.C.M. (CCH) 1536, 1539 (2009); *Farmer v. Comm'r of Internal Revenue*, 68 T.C.M. (CCH) 178, 181 (1994). But, as plaintiffs note, establishing that their partnership was not a sham (or at least not entirely so) is only one of several showings that they must make to obtain their claimed loss deduction. As explained by the Sixth Circuit in *Illes v. Comm'r of Internal Revenue*, 982 F.2d 163, 165 (6th Cir. 1992) (citations omitted), *cert. denied*, 507 U.S. 984 (1993) –

> To be valid, an asserted deduction must satisfy both components of a two-part test. The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction. If, however, the court determines that the transaction is a sham, the entire transaction is disallowed for federal tax purposes, and the second inquiry is never made.

See also Forseth v. Comm'r of Internal Revenue, 845 F.2d 746, 748 (7th Cir. 1988); *Enrici v. Comm'r of Internal Revenue*, 813 F.2d 293, 295 (9th Cir. 1987). These cases teach that a court ascertaining

whether a deduction is allowable under section 165(c)(2) must approach that matter from a dual perspective – training one eye on the partnership, to be sure, but the other on the individual partner involved.[7] Indeed, the latter focus often predominates, for most of the questions involving the deductibility of an abandonment loss under section 165 sound at the partner-level, including those involving the individual partner's motivation, the extent of his or her investment, and the adjusted basis of the partnership interest at the time of its abandonment.

Given this twin focus, it is natural to conclude that whether plaintiffs are entitled to a loss deduction here is not, as defendant claims, a partnership item, but rather, as plaintiffs assert, an affected item within the meaning of TEFRA – that is to say, an item (the deductibility of losses

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[7] *See Marinovich v. Comm'r of Internal Revenue*, 77 T.C.M. (CCH) 2075, 2076 (1999) ("Under section 165(c)(2), in order for individual taxpayers to be entitled to loss deductions with respect to funds invested in partnerships, the underlying partnership transactions must have economic substance, and, at the partner level, the individual taxpayers must have had a profit objective for investing in the partnerships."); *Wright v. Comm'r of Internal Revenue*, 67 T.C.M. (CCH) 3125, 3126 (1994) ("[W]e have consistently held that even if a taxpayer invests with the subjective intent of making a profit, the investment will not be recognized for tax purposes if the overall transaction lacks economic substance and business purpose.").

under section 165) "affected by a partnership item" (whether the partnership here was a sham). *See* Treas. Reg. § 301.6231(a)(5)-1(a). It is the sort of affected item that "require[s] findings of fact peculiar to the particular partner." *Bob Hamric Chevrolet, Inc v. United States*, 849 F. Supp. 500, 511 (W.D. Tex. 1994); *see also N.C.F. Energy Partners v. Comm'r of Internal Revenue*, 89 T.C. 741, 744 (1987). In such instances, "[it] is well-established that the partnership prong of an affected item . . . must be determined first in a unified partnership proceeding," with "[t]he result from that proceeding . . . then [being] applied at the individual partner level to the extent that it impacts what otherwise is a nonpartnership item." *Keener*, 76 Fed. Cl. at 460.[8] *Keener* and like cases

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[8] *Katz v. Comm'r of Internal Revenue*, 335 F.3d 1121, 1124 (10th Cir. 2003); *Clark v. United States*, 68 F. Supp. 2d 1333, 1347 (N.D. Ga. 1999); *Bedrosian v. Comm'r of Internal Revenue*, 94 T.C.M. (CCH) 614, 616 (2007) ("Because the tax treatment of affected items depends on partnership-level determinations, affected items cannot be tried as part of a partner's personal tax case until the resolution of the partnership proceeding."); *GAF Corp. & Subs. v. Comm'r of Internal Revenue*, 114 T.C. 519, 528 (2000) ("[B]ecause the tax treatment of an 'affected item' depends upon the partnership-level determination, affected items generally cannot be tried as part of a partner's tax case prior to the completion of the partnership-level proceeding." (quoting *Gillilan v. Comm'r of Internal Revenue*, 66 T.C.M. (CCH) 398, 401 (1993))); *Dubin v. Comm'r of Internal Revenue*, 99 T.C. 325, 328 (1992);

thus teach that "partners must first raise any partnership item that 'affects' their personal items at the partnership-level proceeding – they must, in other words, obtain resolution of the partnership prong of their affected items before later turning to the affected nonpartnership prong." *Id.* at 461. Logic and experience, not to mention the relevant Code provisions, suggest that the same result should obtain if the partnership prong of an affected item is itself converted into a nonpartnership item as the result of a settlement. *See Weiner v. United States*, 389 F.3d 152, 155 (5th Cir. 2004), *cert. denied*, 544 U.S. 1050 (2005); *Mellina v. United States*, 518 F. Supp. 2d 825, 828-29 (N.D. Tex. 2007); *see also Schell v. United States*, 84 Fed. Cl. 159, 167-68 (2008); *Prati*, 81 Fed. Cl. at 436; *Keener*, 76 Fed. Cl. at 463-64. Hence, whether the sham issue here was resolved in a prior partnership level proceeding or converted into a nonpartnership item by virtue of a qualifying settlement, the result seemingly is the same – section 7422(h) would no longer bar this court from exercising jurisdiction as a resulting

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Maxwell v. Comm'r of Internal Revenue, 87 T.C. 783, 792-93 (1986). Courts also have jurisdiction over affected items when the IRS accepts the partnership return as filed because that fulfills the requirement that there be an "outcome of a partnership proceeding." *Roberts v. Comm'r of Internal Revenue*, 94 T.C. 853, 860 (1990); *see* 26 U.S.C. § 6230(c)(4); *Ginsburg v. Comm'r of Internal Revenue*, 127 T.C. 75, 83 (2006).

refund would no longer be "attributable to" a partnership item within the meaning of that section.

Plaintiffs assert that the "sham" transaction issue was resolved in their favor by the settlement agreement. They contend that their settlement, which was embodied in an IRS Form 870-P(AD), was "comprehensive;" that, *a fortiori*, the sham issue was necessarily resolved in their favor by that settlement; thereby converting what would otherwise be a partnership item into a nonpartnership item. This is a shorthand version of an argument that this court thoroughly considered and rejected in *Keener*. There, plaintiffs likewise argued that an issue – involving the statute of limitations – had been converted into a nonpartnership item because their settlement agreement was "comprehensive" and had failed to resolve that issue adversely to plaintiffs. Rebuffing this assertion, this court first noted that neither the Code nor the Treasury Regulations require that a TEFRA settlement resolve all of the issues presented by a given partner's return. In this regard, the court specifically rejected the notion that such a rule sprang from Treas. Reg. § 301.6224(c)-3T(b) (1987), which states that "[s]ettlements shall be comprehensive, that is, a settlement may not be limited to selected items." *See Keener*, 76 Fed. Cl. at 465. In holding that this regulation did not support the plaintiffs, the court elaborated –

> A careful review reveals that this regulation had nothing to do with the scope of all TEFRA settlements, but rather was designed only to implement the requirement under section 6224(c) of the Code that if the IRS enters into a settlement agreement with any partner, it shall offer any other partner who so requests settlement terms consistent with those contained in the first settlement agreement. Placed in its proper context, it is readily apparent that not every TEFRA settlement had to be "comprehensive" under this regulation, but rather only those subsidiary agreements entered into based upon the consistency requirement – in other words, the regulation sensibly indicates that to obtain a consistent settlement, the second partner seeking to settle must agree to all the terms that were in the original settlement.

Id. The Keeners' position, the court went on to note, conflicted with section 6231(b)(1)(C) of the Code,[9] which plainly envisions that the

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[9] That subparagraph provides –

> **(b) Items cease to be partnership items in certain cases.** –
>
> **(1) In general.**– For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become

partnership/nonpartnership conversion occurs only as to specific individual items. It observed that "[u]pon close reading, the language of section 6231(b)(1)(C) plainly applies on an item-by-item basis, as it states that the partnership items of a partner shall become nonpartnership items as of the date the Secretary enters into a settlement agreement with the partner with respect to 'such items.'" *Id.* at 464. "The last phrase, of course, would be superfluous," the court added, "if, as plaintiffs intimate, the entry of a settlement agreement as to **any** partnership item converts **every** partnership item into a nonpartnership item." *Id.* (emphasis in original).

This reasoning comfortably fits the case at hand. Indeed, this same reasoning was applied in *Schell*, which involved an analogous situation – the taxpayer entered into a settlement that did not address the sham transaction issue, but claimed that the settlement was "comprehensive and conclusive" and thus had the effect of converting the sham issue into a nonpartnership item.

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nonpartnership items as of the date –

* * * * *

(C) the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner with respect to such items . . . .

Relying on *Keener*, the court made short shrift of this claim, opining –

> Although Section 6231(b)(1)(C) converts partnership items into non-partnership items upon a settlement agreement, this provision applies only where partnership items ***specifically*** were settled by agreement. . . . As previously discussed, the April 28, 1997 Settlement Agreements did not address the sham-transaction issue. . . . Accordingly, those "partnership items" *ipso facto* were not converted upon settlement to "non-partnership" items.

Schell, 84 Fed. Cl. at 167-68 (emphasis in original); *see also Prati*, 81 Fed. Cl. at 436-37 (concluding that a limitations issue "not being part of any settlement agreement [was] not converted into a nonpartnership item"); Willis, *supra*, at ¶ 20.02[5]. As in *Schell*, this court finds that the settlement agreement in question did not convert the determination of whether ACVA had conducted sham transactions into a nonpartnership item.

2.

That said, there is still the matter of the Tax Court's decision. As noted, on July 19, 2001, the Tax Court issued a decision that disallowed approximately $16 million of the farming expense deductions claimed by ACVA, reducing the partnership's originally-reported net loss by

approximately 47 percent. The Tax Court held that the adjustments to the partnership's income and expenses were "attributable to transactions which lacked economic substance." Unlike the aforementioned settlement, this decision supplies the necessary predicate for this court to exercise jurisdiction over plaintiffs' section 165 loss claim. To be sure, the ambiguity of the decision raises some questions as to its impact on the availability of the claimed loss deduction here. But, those questions go to the merits and are for another day. They do not preclude this court from exercising jurisdiction over the nonpartnership prong of the affected item presented by plaintiffs' loss deduction.

In sum, this case presents questions involving the nonpartnership prong of an affected item, over which this court has jurisdiction because the partnership prong of that item has already been decided. *See Nault v. United States*, 2007 WL 465310, at *4 (D.N.H. Feb. 9, 2007), *aff'd*, 517 F.3d 2 (1st Cir. 2008) (applying prior Tax Court sham ruling in partnership proceeding in holding taxpayer-partner not entitled to loss deduction under section 165(c)(2)).[10] This is not a case

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[10] *See also Desmet v. Comm'r of Internal Revenue*, 581 F.3d 297, 304 (6th Cir. 2009) ("TEFRA's purpose is not to completely eliminate partner-level determinations;" instead, the statute "contemplates the necessity of partner-level proceedings in some situations"); *Russian*

involving losses distributed by the partnership, as is true of most of the cases cited by defendant in arguing that this court lacks jurisdiction. Because the latter cases focus solely on the activities of the partnership, they present issues resolvable at the partnership level that are preeminently "partnership items" within the parlance of TEFRA.[11] For the reasons discussed above, this

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Recovery Fund Ltd. v. United States, 81 Fed. Cl. 793, 800-01 (2008); *Clark*, 68 F. Supp. 2d at 1348 ("[j]urisdiction is proper in [district] court" where partnership-prong of affected item already resolved by Tax Court).

[11] By and large, these cases involve whether a partner's distributive share of partnership losses is deductible under section 162(a) of the Code. *See Hill v. Comm'r of Internal Revenue*, 204 F.3d 1214 (9th Cir. 2000); *Hildebrand v. Comm'r of Internal Revenue*, 28 F.3d 1024 (10th Cir. 1994), *cert. denied*, 513 U.S. 1079 (1995); *Wolf v. Comm'r of Internal Revenue*, 4 F.3d 709 (9th Cir. 1993); *Pasternak v. Comm'r of Internal Revenue*, 990 F.2d 893 (6th Cir. 1993); *Cannon v. Comm'r of Internal Revenue*, 949 F.2d 345 (10th Cir. 1991), *cert. denied*, 505 U.S. 1220 (1992); *Evans v. Comm'r of Internal Revenue*, 908 F.2d 369 (8th Cir. 1990); *Simon v. Comm'r of Internal Revenue*, 830 F.2d 499 (3d Cir. 1987); *Tallal v. Comm'r of Internal Revenue*, 778 F.2d 275 (5th Cir. 1985). Other cases cited by defendant hold that the sham transaction determination must be made at the partnership level, but involve situations in which no determination as to that issue was made prior to the filing of a partner-level suit. *See, e.g., Schell*, 84 Fed. Cl. at 168 (holding that the court lacked jurisdiction to adjudicate a partner's abandonment loss deduction claim because no

case is different. Though the issues left for this court to consider may well be shared by other partners in ACVA, they, nonetheless, focus on the statutory requirements of section 165 that indisputably apply at the individual level. Consideration of these issues thus does not risk the sorts of inconsistency and duplication of litigation which TEFRA was enacted to prevent.

Having concluded it has jurisdiction to address plaintiffs' claim, the court now turns to the merits portion of defendant's summary judgment motion.

C.

Many of defendant's arguments on the merits raise material questions of fact and thus are unsuitable for resolution as a matter of law.[12]

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applicable sham determination had been made at the partnership level). There can, of course, be instances in which the determination of the adjusted basis of a partnership interest is a partnership item – for example, where the basis depends, under section 732, on partnership property. *See* 26 U.S.C. §732(b)-(c). Nonetheless, "[g]enerally, the basis for a partner's partnership interest and the factors entering into the determination of that basis are not partnership items." Willis, *supra*, at ¶20.02[4][a][iv].

[12] Take, for example, defendant's contentions regarding how the Tax Court's decision should be construed and the nature of the income distributed by ACVA after 1986 and how it impacts the basis calculation.

However, one of defendant's contentions – that plaintiffs had a zero basis in their partnership interest, leaving them nothing to deduct – presents a legal question that seems resolvable via summary judgment. And it is resolvable, as it turns out, in defendant's favor.

Recall that, under section 165, a partner may claim a loss deduction for the abandonment of his partnership interest equal to his adjusted basis therein. 26 U.S.C. § 165(b); *see also Parmelee Transp.*, 351 F.2d at 623 n.2.[13] Under section 722 of the Code, the basis of an interest in a partnership acquired by a contribution of money is the amount of the money. *See Marriott*, 2009 WL 3447443, at *9. To that figure is added the amount of any partnership liabilities assumed by the partner. 26 U.S.C. § 752(a); *see also* Treas. Reg. §1.705-1(a)(2).[14]

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[13] This is sometimes referred to as the partner's "outside basis." "A partnership's basis in its assets is referred to as its 'inside basis,'" the Federal Circuit recently explained, "and a partner's basis in his or her partnership interest is called his or her 'outside basis.'" *Marriott Int'l Resorts, L.P. v. United States*, 2009 WL 3447443, at *9 (Fed. Cir. Oct. 28, 2009) (per curiam) (quoting *Kligfeld Holdings v. Comm'r of Internal Revenue*, 128 T.C. 192, 195-96 (2007)).

[14] The practical impact of these adjustments has been well-described as follows:

> By treating the partners as contributing cash in an

Section 705 of the Code governs the adjustment of this basis to account for, *inter alia*, the partner's distributive share of partnership income and losses. Subsection (a) of that section provides, in relevant part –

> (a) **General rule**.– The adjusted basis of a partner's interest in a partnership shall, except as provided in subsection (b), be the basis of such interest determined under section 722 (relating to contributions to a partnership) or section 742 (relating to transfers of partnership interests) –

> amount equal to their shares of the debt, inside/outside basis equality is preserved and distortions are avoided. If a liability for borrowed money were not added to the partners' bases, they could be taxed on a distribution of the borrowed cash even though there is no gain inherent in the partnership's assets. A similar result could occur if a partnership incurs a purchase money liability to acquire property, since the liability is added to the partnership's basis in the property.

William S. McKee, William F. Nelson & Robert L. Whitmire, Federal Tax'n of Partnerships and Partners ¶7.01[1], at 7-2 (3d ed. 1997); *see also Marriott*, 2009 WL 3447443, at *9; *Coloman v. Comm'r of Internal Revenue*, 540 F.2d 427, 429 (9th Cir. 1976); *Salina P'shp. LP v. Comm'r of Internal Revenue*, 80 T.C.M. (CCH) 686, 696-97 (2000).

(1) increased by the sum of his distributive share for the taxable year and prior taxable years of –

(A) taxable income of the partnership as determined under section 703(a),

(B) income of the partnership exempt from tax under this title, and

(C) the excess of the deductions for depletion over the basis of the property subject to depletion;

(2) decreased (but not below zero) by distributions by the partnership as provided in section 733 and by the sum of his distributive share for the taxable year and prior taxable years of –

(A) losses of the partnership, and

(B) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account; . . . .

These adjustments ensure that a partner's adjusted basis in the partnership interest reflects his economic investment in the partnership, so that the partner realizes an amount of gain or loss on the sale or other disposition of that interest that accurately reflects the partner's economic gain or

loss.[15] Under the Treasury Regulations, "[a] partner is required to determine the adjusted basis of his interest in a partnership only when necessary for the determination of his tax liability or that of any other person." Treas. Reg. §1.705-1(a); McKee, *supra*, at ¶6.02[2].

While the parties agree that plaintiffs' adjusted basis in their partnership interest governs the amount of any deductible loss under section 165, they vociferously disagree on how to calculate that adjusted basis. To illustrate their differences, consider the following example –

> Assume that partner A becomes a partner in the AB partnership on January 1 and has an initial basis in the partnership of $1,000 (calculated under sections 722 and 752 of the

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[15] *See Marriott*, 2009 WL 3447443, at *14 (the adjustment provisions were "intended to avoid distortions in the tax reporting of partnership items by promoting parity between a partnership's aggregate inside basis in its assets and its partners' outside bases in their partnership interests") (quoting *Salina P'ship*, 80 T.C.M. (CCH) at 698)); *see also* William S. McKee, William F. Nelson & Robert L. Whitmire, Federal Tax'n of Partnerships and Partners ¶6.02[2] (4 ed. 2009) (hereinafter "McKee") ("The purpose of the § 705(a) adjustments is to keep track of a partner's 'tax investment' in the partnership with a view toward preventing double taxation or exclusion from taxation of income items upon ultimate disposition of the partnership interest.").

> Code). For that year, year one, the partnership has a loss of $100,000, of which A's distributive share is $3,000. Then, in the succeeding year, year two, the partnership has income of $33,333, of which A's distributive share is $1,000. At the end of that second year, A abandons his interest in the partnership. What is his adjusted basis in his partnership at the time of this abandonment?

Plaintiffs essentially claim that the adjusted basis at the time of the abandonment should be $1,000 – that although A's share of the distributive losses exceeded his original basis by $2,000, his adjusted basis could never be reduced below zero; it then became $1,000 when the partnership distributed the $1,000 of income in year two ($ Ø (adjusted basis in first year) + $1,000 (adjustment for second year) = $1,000). This leads, according to plaintiffs, to an abandonment deduction of $1,000. For its part, defendant asserts that the partner's adjusted basis in his partnership interest at the time of the abandonment is zero. It starts with the partner's basis of $1,000, adds thereto the sum of subsequent distributions of income ($1,000), and then subtracts therefrom the sum of subsequent distributions of loss ($3,000). Defendant notes that while these calculations leave the taxpayer with a negative adjusted basis (-$1,000), section 705(a)(2) sets that basis to zero, with the latter number then corresponding to the amount of the abandonment

deduction. ($1,000 (original basis) + $1,000 (sum of distributed income) - $3,000 (sum of distributed losses) = -$1,000 or Ø).

Not surprisingly, the actual calculations in this case are a bit more complex. Lest this complexity serve to obscure the parties' respective positions, it is worth making several precatory observations before proceeding to the numbers. First, there are many more taxable years here than in the example above, reflecting a more varied distribution of income and losses. Yet, the rub here remains the same – how to calculate the adjusted basis of the partnership interest where there is an initial contribution to the partnership, followed by a large distributed loss that exceeds the partner's original basis, and then some distributed income. Second, unlike the example above, plaintiffs calculate an adjusted basis for each year in this lengthy sequence, while defendant determines the adjusted basis only at the time of the claimed deduction. As will be discussed in greater detail, this seemingly minor detail masks a much larger dispute between the parties. Finally, while the parties agree that plaintiffs invested $26,000 in cash in the partnership, they differ as to how much liability plaintiffs initially assumed – defendant claims this amount was $41,600, while plaintiffs assert that,

at most, it was $8,141.[16] This causes the parties to begin with different original bases for the partnership interest ($34,141 and $67,600 for plaintiffs and defendant, respectively). This difference, however, ultimately falls out of the calculation, as both parties agree that from 1994 through 1999, plaintiffs were relieved of whatever debt they originally assumed.

With this preface, the accompanying chart generally encapsulates the parties' respective positions:

	Plaintiffs' Distributive Share of Income and Loss	Sum of Distributive Income Minus Distributive Loss	Plaintiffs' Adjusted Basis	Defendant's Adjusted Basis
Original Basis	----	----	$34,141	$67,600
1986	($69,380)	($69,380)	0	X
1987	$3,784	($65,596)	$ 3,784	X

[16] Plaintiffs derive the amount of liabilities they assumed from the amount of the 1986 loss they were permitted to deduct under the Form 870-P(AD) settlement. Because a partner may not deduct distributed losses in excess of the adjusted basis in his partnership interest, *see* 26 U.S.C. § 704(d), plaintiffs abductively reason that, in 1986, they must have had sufficient basis to allow for the $34,141 deduction they were granted under the settlement. They calculate that since their cash contribution was $26,000, the amount of partnership debt that they assumed must have been $34,141 less that amount, or $8,141.

1988	$6,661	($58,935)	$10,445	X
1989	$7,217	($51,718)	$17,662	X
1990	$5,708	($46,010)	$23,370	X
1991	$7,683	($38,327)	$31,053	X
1992	$2,764	($35,563)	$33,817	X
1993	$3,972	($31,591)	$37,789	X
1994	$2,088	($29,503)	$39,877	X
1995	$5,771	($23,732)	$45,648	X
1996	$6,249	($17,483)	$51,897	X
1997	($ 1,004)	($18,487)	$50,893	X
1998	($ 535)	($19,022)	$50,358	X
1999	($ 8,380)	($27,402)	$41,978	$40,198
Subtotal	**($27,402)**	**($27,402)**	**$41,978**	**$40,198**
Reduction in Liabilities (1994-1999)			($8,141)	($41,600)
Final Adjusted Basis			**$33,837**	**0 (per § 705(a)(2))**

As can be seen, plaintiffs maintain that their final adjusted basis in their partnership interest was $33,837, while defendant counters that the basis was a negative number which, via section 705(a) of the Code, is set at zero.[17] The effect of defendant's

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[17] The negative number is produced by subtracting from $40,198 (the number produced by reducing plaintiffs' original basis to reflect the partnership's distributed income) $41,600 (the figure corresponding to the amount of partnership liabilities from which plaintiffs were released). Defendant's calculation would yield the same result (*i.e.*, a negative number that would be set to zero) if the reductions in liabilities were accounted for in the actual years those liabilities were reduced. K-1 forms in the record suggest

position, of course, is to deny plaintiffs any claimed loss deduction.

In the court's view, defendant's position pays more respect to the statutory language. Section 705(a) requires that the adjusted basis be determined by increasing the original basis by "the sum of [the partner's] distributive share for the taxable year and prior taxable years" of partnership income, and decreasing it "by the sum of his distributive share for the taxable year and prior taxable years" of losses. As a textual matter, these words clearly anticipate that the calculation will be cumulative and reflect a partner's entire period of ownership – why else would the statute require that income and losses from not just the current taxable year or any set of years, but all ***prior*** years be summed in making the calculation.

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that those reductions occurred in the following fashion:

	Plaintiffs' share of liabilities as reported on K-1 forms	**Change in plaintiffs' share of liabilities**
1991	$41,600	
1992	$41,608	$8
1993	$41,607	($1)
1994	$13,234	($28,373)
1995	$7,108	($ 6,126)
1996	$0	($ 7,108)

As such, it would appear that if a partnership incurs and distributes a significant loss in one taxable year, that loss is carried along in ultimately calculating what the adjusted basis of a partnership interest would be in a later year. This is important because, of course, the statute dictates that the adjusted basis at any particular point cannot go "below zero." The latter phrase, however, does not alter the way that the rest of the statute operates – it does not mean that the sum of the distributive shares of income and losses over the history of the partnership is permanently set to zero at any point that the sum becomes negative. For if that were true, the calculation of the adjusted basis in subsequent years would not reflect the sum of the distributive shares "for the taxable year and ***prior*** taxable years" -- such prior losses would be largely, and, in some cases, entirely, factored out of the equation, a result that cannot be squared with the statutory formula.

Nor, as plaintiffs intimate, does the statute envision that the calculation of the adjusted basis in the partnership interest for one year begins with the basis value set for the immediately prior year, with any negative result for that prior period being set to zero. Instead, more fluidly and comprehensively, it anticipates that the calculation of adjusted basis will occur only when needed and that the calculation, to that point in time, will reflect all preceding distributed income and losses. Perhaps hinting at this result, the relevant

Treasury Regulation states that the adjusted basis need be determined "only when necessary for the determination of [the partner's] tax liability or that of any other person." Treas. Reg. § 1.705-1(a)(1). Though a subtle point, that the adjusted basis need not be calculated annually provides a further clue that plaintiffs are simply wrong in suggesting that the calculation of adjusted basis for one year begins with the comparable figure for the immediate past year.

Defendant's reading of the statute, moreover, finds support in its legislative history. Prior to the 1954 Code, there were no provisions in the federal income tax laws that specifically dealt with the treatment of the sale of a partnership interest. Before 1950, the Internal Revenue Bureau, indeed, had treated the sale of a partnership interest as a sale of the selling partner's undivided interest in each specific partnership asset. *See* G.C.M. 10092, 11-1 C.B. 114 (1932). But, this view was repeatedly rejected by the courts,[18] leading the Bureau to

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[18] *Swiren v. Comm'r of Internal Revenue*, 183 F.2d 656, 660 (7th Cir. 1950), *cert. denied*, 340 U.S. 912 (1951); *McClellan v. Comm'r of Internal Revenue*, 117 F.2d 988, 988 (2d Cir. 1941); *Comm'r of Internal Revenue v. Smith*, 173 F.2d 470, 470 (5th Cir.), *cert. denied*, 338 U.S. 818 (1999); *Thornley v. Comm'r of Internal Revenue*, 147 F.2d 416, 422 (3d Cir. 1945); *Comm'r of Internal Revenue v. Shapiro*, 125 F.2d 532, 535 (6th Cir. 1942); *Stilgenbaur v. United States*, 115 F.2d 283, 287 (9th Cir. 1940); *Shapiro v. United States*,

adopt the prevailing view that "the sale of a partnership interest should be treated as the sale of a capital asset under the provisions of section 117 of the [1939] Code." G.C.M. 26379, 1950-1 C.B. 58. Applying the rules found in section 113 of the 1939 Code, the Treasury Regulations in effect at this time required that the basis in a partnership interest be adjusted to reflect the "net income earned since [the partner] became a partner." Treas. Reg. 118, § 39.113(a)(13)-2(a) (1953). Both the courts and commentators viewed the regulation as requiring a partner's adjusted basis in his partnership interest to be reduced by the partnership's historical losses.[19] In enacting section

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83 F. Supp. 375, 376-77 (D. Minn.), *aff'd*, 178 F.2d 459 (8th Cir. 1949).

[19] *See Senner v. Comm'r of Internal Revenue*, 22 B.T.A. 655, 657 (1931); *Appeal of Meyer*, 3 B.T.A. 1329, 1333 (1926); Paul Little, Federal Income Taxation of Partnerships § 7.15 (1952). As observed by another set of commentators –

> Despite the obvious importance of this concept, the 1939 Code did not contain any definition of the basis of a partner's interest in the partnership. Under the Regulations, however, it appeared that a partner's original basis for his interest would equal either: (a) any money plus the basis in his hands of any property contributed to the partnership; (b) the price paid in purchasing the interest from another partner; or (c) in the case of an inherited interest, its value at the date of the deceased partner's death.

705, as part of the 1954 Code, Congress made clear its intent to adopt the existing practice for calculating the adjusted basis of a partnership interest. *See* H. R. Rep. No. 1337, at A224-25 (1954) ("While there are no provisions in the 1939 Code analogous to the provisions in this section, the adjustments required are in accord with existing practice."); S. Rep. No. 1622, at 384 (1954) (same).[20] Although these reports do not specifically

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> This original basis would then be increased by the partner's distributive share of any partnership gain taxed to him and would be decreased by his distributive share of any partnership loss and by the amount of any money or the basis in his hands of any property distributed to him by the partnership.

J. Paul Jackson, Mark H. Johnson, Stanley S. Surrey, Carolyn K. Tenen & William C. Warren, "The Internal Revenue Code of 1954: Partnerships," 54 Colum. L. Rev. 1183, 1192 (1954) (citing Treas. Reg. 118, § 39.113(a)(13)-1, 2); *see also Sherlock v. Comm'r of Internal Revenue*, 34 T.C. 522, 526 (1960), *aff'd*, 294 F.2d 863 (5th Cir. 1961), *cert. denied*, 369 U.S. 802 (1962); Peter Miller, "Capital Gains Taxation of the Fruits of Personal Effort: Before and Under the 1954 Code," 64 Yale L.J. 1, 34 n.205 (1954).

[20] Echoing these sentiments, the Joint Committee on Internal Revenue Taxation, in its explanation of the 1954 Code, stated that "[a]lthough the statutory provisions of the 1939 Code did not provide for the adjustments described above with respect to the basis of a partner's interest in a partnership, these adjustments were implicit in the provisions and regulations then in effect." Jt. Comm. on Internal Revenue Tax'n, "Summary of the New Provisions

address the issue at hand, they do indicate that the "adjustments to the basis of a partner's interest are necessary to prevent unintended benefit . . . to the partners." H. R. Rep. No. 1337, at A225; S. Rep. No. 1622, at 384. By way of example, they note that "the partner's share of nondeductible expenditures must be deducted from his basis in order to prevent such amounts from eventually constituting capital loss to him." H. R. Rep. No. 1337, at A225; S. Rep. No. 1622, at 384.[21] At all events, there is not a shred of evidence in these reports to suggest that Congress intended a partner's adjusted basis to be calculated in the balkanized fashion that plaintiffs have offered.[22]

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of the Internal Revenue Code of 1954" 89 (Feb. 1955).

[21] *See also* Mertens, *supra*, at § 35:23 ("The amount of expenditures that are nondeductible and not properly chargeable to a capital account must decrease the outside basis in order to prevent a conversion of a nondeductible expenditure into a recognized loss."); Partnership – Allocation of Liabilities; Basis Rules 714 3rd T.Mgmt. IV-A(7) (BNA) (2009) ("This basis decrease is necessary to ensure that a partner cannot convert a nondeductible expenditure into a recognized loss upon the sale or disposition of the interest.").

[22] Although not cited by either party, research reveals one case – *Falkoff v. Comm'r of Internal Revenue*, 62 T.C. 200, 208 (1974) – that appears to calculate adjusted basis in a fashion similar to that argued by plaintiffs. That case, however, deals with an undistributed negative capital

There is little doubt in the court's mind that what plaintiffs seek here is essentially that which the Congress, in 1954, forbade – *to wit*, the conversion of disallowed partnership deductions into an allowable loss deduction upon an individual partner's later disposition of his partnership interest. Plaintiffs, of course, say no. But, one would have to don blinders bigger than old Dobbins' to ignore that plaintiffs' deduction here stems from their failure to reflect fully, in their basis calculation, the losses previously incurred by ACVA. The statute and the Treasury Regulations require the basis calculation to reflect cumulatively all income and non-capital expenditures from prior years; yet, plaintiffs' approach essentially begins the calculation only in the year following that in which ACVA incurred substantial nondeductible expenditures. But, there is no reset button here; nor even an accounting principle lurking (as is true elsewhere in the Code). And that poses a big problem for plaintiffs whose method of calculating basis, unlike the statutorily-prescribed method, appears highly sensitive to the sequencing of income and nondeductible expenditures. Under

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account and the Tax Court has subsequently limited *Falkoff* to its facts. *See Tapper v. Comm'r of Internal Revenue*, 52 T.C.M. (CCH) 1230, 1240 (1986). To the extent *Falkoff* can be read more broadly as authorizing plaintiffs' approach to basis calculation, this court, for the host of reasons indicated above, refuses to follow it.

their method, if, for example, the pattern here were reversed and the income was received in the earlier years and the nondeductible expenditures occurred in a later year, there would be no basis associated with plaintiffs' abandoned partnership interest.[23]

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[23] The chart below shows the dramatic impact of using plaintiffs' method for calculating basis, but shifting the major loss year from the beginning to the end of the sequence:

	Plaintiffs' Distributive Share of Income and Loss	Sum of Distributive Income Minus Distributive Loss	Plaintiffs' Adjusted Basis	Defendant's Adjusted Basis
Original Basis	----	----	$34,141	$67,600
1986	$ 3,784	$ 3,784	$37,925	X
1987	$ 6,661	$10,445	$44,586	X
1988	$ 7,217	$17,662	$51,803	X
1989	$ 5,708	$23,370	$57,511	X
1990	$ 7,683	$31,053		X
1991	$ 2,764	$33,817	$67,958	X
1992	$ 3,972	$37,789	$71,930	X
1993	$ 2,088	$39,877	$74,018	X
1994	$ 5,771	$45,648	$79,789	X
1995	$ 6,249	$51,897	$86,038	X
1996	($ 1,004)	$50,893	$85,034	X
1997	($ 535)	$50,358	$84,499	X
1998	($ 8,380)	$41,978	$76,119	X
1999	($69,380)	($27,402)	$ 6,739	$40,198
Subtotal	($27,402)	($27,402)	$ 6,739	$40,198

Such wildly varying results cannot be what Congress intended in requiring the adjusted basis to reflect the impact of the partner's share of income and expenses from not only the taxable year, but all prior years. Moreover, it does not follow that because the statute prevents the partnership basis from ever going below zero, Congress intended to introduce arbitrariness into the calculation of basis – with the end result fluctuating greatly based upon the pattern of income and losses, rather than the net sum thereof. While "[l]ogic and taxation are not always the best of friends," *Sonneborn Bros. v. Curèton*, 262 U.S. 506, 522 (1923) (McReynolds, J., concurring), this court will not attribute to Congress such illogical results, without the flimsiest of textual support and in the face of legislative history suggesting an opposite intent.

Finally, "[s]ince context gives meaning," *United States v. Santos*, 128 S. Ct. 2020, 2024 (2008), it is

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Reduction in Liabilities (1994-1999)			($8,141)	($41,600)
Final Adjusted Basis			**0 (per § 705)**	**0 (per § 705)**

Accordingly, using the same net sum of income and losses, plaintiffs' method produces wildly different results depending upon when large expenditures arise.

noteworthy that plaintiffs' method of calculating basis cannot be reconciled with section 704(d) of the Code, which limits the deductibility of distributed partnership losses. That subsection allows for the deduction of a partner's distributive share of a partnership loss "only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred." 26 U.S.C. § 704(d); *see also Comm'r of Internal Revenue v. Tufts*, 461 U.S. 300, 315 (1983). Under that provision, the nondeductible portion of a loss may be carried forward and deducted in a subsequent year in which additional basis is generated.[24] In this regard, Treas. Reg. 1.704-1(d)(1) provides –

> (d) Limitation on allowance of losses. (1) A partner's distributive share of partnership loss will be allowed only to the extent of the adjusted basis (before reduction by current year's losses) of such partner's interest in the partnership at the end of the partnership taxable year in which such loss occurred. A partner's share of loss in excess of his adjusted basis at the end of the partnership taxable year will not be allowed for that

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[24] *See* S. Rep. No. 1622, at 383 ("any loss in 24 excess of the basis of a partner's partnership interest may be allowed as a deduction only at the end of the partnership year in which the loss is repaid, either directly, or out of future profits").

> year. However, any loss so disallowed shall be allowed as a deduction at the end of the first succeeding partnership taxable year, and subsequent partnership taxable years, to the extent that the partner's adjusted basis for his partnership interest at the end of any such year exceeds zero (before reduction by such loss for such year).

See also Sennett v. Comm'r of Internal Revenue, 80 T.C. 825, 829 (1983), *aff'd*, 752 F.2d 428 (9th Cir. 1985); *Chong v. Comm'r of Internal Revenue*, 93 T.C.M. (CCH) 687, 689 (2007) ("if [a partner's distributive share of partnership losses is greater than his available adjusted basis, the excess loss can't be claimed in that year but must instead be carried forward until he once again has adjusted basis available to offset the loss"). As an accompanying example in the regulation illustrates,[25] the carryforward of the disallowed

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[25] Example 1 in this regulation states:

> At the end of the partnership taxable year 1955, partnership AB has a loss of $20,000. Partner A's distributive share of this loss is $10,000. At the end of such year, A's adjusted basis for his interest in the partnership (not taking into account his distributive share of the loss) is $6,000. Under section 704(d), A's distributive share of partnership loss is allowed to him (in his taxable year within or with which the partnership taxable year ends) only to the extent of his adjusted basis of $6,000. The

portion of the partner's share of deductible losses presumes that any subsequent income distributed by the partnership will be absorbed by the carryforward, leaving the adjusted basis of the partnership interest at zero until such time as subsequent income exceeds the carried-forward loss. Since the carried-forward loss effectively shields subsequent distributed income of the partnership from taxation, allowing the partner to

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> $6,000 loss allowed for 1955 decreases the adjusted basis of A's interest to zero. Assume that, at the end of partnership taxable year 1956, A's share of partnership income has increased the adjusted basis of A's interest in the partnership to $3,000 (not taking into account the $4,000 loss disallowed in 1955). Of the $4,000 loss disallowed for the partnership taxable year 1955, $3,000 is allowed A for the partnership taxable year 1956, thus again decreasing the adjusted basis of his interest to zero. If, at the end of partnership taxable year 1957, A has an adjusted basis for his interest of at least $1,000 (not taking into account the disallowed loss of $1,000), he will be allowed the $1,000 loss previously disallowed.

This example serves to illustrate that as the undeducted portion of the distributed loss is carried forward, subsequent distributions of partnership income do not contribute to a positive basis until such time as the carried-forward loss is fully absorbed. That result, as the foregoing suggests, springs not only from section 704(d), but also from a proper construction of section 705(a) of the Code.

treat that income as also contributing to a positive basis could lead to a double deduction – one taken at the time that the carried-forward losses were deducted and another when the partnership interest is later abandoned. Again, this makes no sense and cements the view that plaintiffs' construction of the relevant provisions is erroneous.[26]

In sum, the court finds, as a matter of law, that plaintiffs' basis in their partnership interest at the time of the alleged abandonment was zero. Plaintiffs, therefore, are not entitled to the deduction claimed.[27]

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[26] Plaintiffs could not take advantage carryforward to the extent that their distributed losses were nondeductible. That, of course, may be precisely the reason why they have pursued instead their novel abandonment theory. But, the fact remains that their construction of the basis adjustment rules of section 705 would apply whether *vel non* losses were deductible, and would, if adopted, give rise to the double deduction scenario described above.

[27] Plaintiffs argue that the ACVA losses disallowed under the settlement agreement should be excluded from their basis calculation, effectively increasing their basis by the amount of disallowed pass-through loss. This argument is based on plaintiffs' claim that the Tax Court's finding as to lack of economic substance results in the entire nonrecognition of the losses at issue, requiring the court to treat those losses as if they never existed. Plaintiffs' argument, however, is directly contradicted by section 705, which explicitly provides that basis must be reduced by

III. CONCLUSION

The court need go no further. Based on the foregoing, it GRANTS defendant's motion for summary judgment. The Clerk is hereby ordered to dismiss the complaint.

IT IS SO ORDERED.

s/ Francis M. Allegra
Francis M. Allegra
Judge

"expenditures of the partnership not deductible in computing its taxable income . . . ." 26 U.S.C. § 705(a)(2)(B); *see also* Treas. Reg. §1.705-1(a)(3)(ii). While this rule might not apply if the partnership made no expenditures whatsoever, that plainly is not the basis upon which either the Tax Court's decision and the plaintiffs' settlement with the IRS proceeded. The decisional law, moreover, plainly suggests that plaintiffs would be in no better position to deduct their supposed losses if the partnership itself was viewed as a factual sham. See *Forseth*, 85 T.C. at 164.

United States Court of Appeals for the Federal Circuit

2008-5004

KENNETH C. KEENER, WILLIAM P. SMITH, and ANNE D. SMITH,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Thomas E. Redding, Redding & Associates, P.C., of Houston, Texas, argued for plaintiffs-appellants. With him on the brief were Teresa J. Womack and Sallie W. Gladney.

Deborah K. Snyder, Attorney, Commercial Litigation Branch, Tax Division, Appellate Section, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were Nathan J. Hochman, Assistant Attorney General, and Michael J. Haungs, Attorney.

Appealed from: United States Court of Federal Claims

Judge Francis M. Allegra

United States Court of Appeals for the Federal Circuit

2008-5004

KENNETH C. KEENER, WILLIAM P. SMITH, and ANNE D. SMITH,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 03-CV-2028 and 04-CV-907, Judge Francis M. Allegra.

DECIDED: January 8, 2009

Before NEWMAN, PROST, and MOORE, Circuit Judges.

PROST, Circuit Judge.

Plaintiffs-Appellants Kenneth C. Keener, William P. Smith, and Anne D. Smith (collectively, "Taxpayers") brought suit against Defendant-Appellee the United States ("the Government") in the United States Court of Federal Claims seeking refunds of federal income taxes and interest paid in connection with their investments in various

partnerships. The Government filed a motion to dismiss for lack of jurisdiction, asserting that I.R.C. §7422(h) foreclosed the court from exercising jurisdiction over Taxpayers' partnership-level challenges in this partner-level suit. The Court of Federal Claims agreed and dismissed Taxpayers' claims for lack of jurisdiction. Keener v. United States, 76 Fed. Cl. 455 (2007). We affirm.

BACKGROUND

Taxpayers invested in partnerships that were part of a larger organization called AMCOR.[1] During the early- to mid-1980s, "AMCOR was in the business of promoting tax shelter partnerships." Crop Assocs.-1986 v. Comm'r of Internal Revenue, 80 T.C.M. (CCH) 56, 59 (2000). In 1984 and 1985, the Taxpayers' partnerships reported ordinary loss deductions, which were apportioned among their partners. As a result, on their income tax returns for 1984 and 1985, Keener and Smith reported their shares of the losses and used those losses to offset their taxable income.

After examining the returns of these partnerships, the Internal Revenue Service ("IRS")

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[1] Specifically, Mr. Keener was a limited partner in Agri-Venture-II during the 1984 tax year and a limited partner in Agri-Venture Fund during the 1985 tax year. Mr. Smith was a limited partner in Richgrove Grape Associates during the 1984 tax year and a limited partner in Desert Highlands Vineyards during the 1985 tax year.

issued a Notice of Final Partnership Administrative Adjustment ("FPAA") to each partnership in 1991. These FPAAs disallowed the ordinary loss deductions reported by each partnership in 1984 and 1985 and, as a result, reduced those deductions to zero. The FPAAs each stated that the deductions were "not allowable for the following reasons," which included, "The partnership's activities constitute a series of sham transactions."

In response, certain partners filed petitions in the Tax Court for readjustment of partnership items pursuant to I.R.C. §6226. Among other challenges, these petitions claimed that the period for assessing tax attributable to the adjusted partnership items had expired prior to issuance of the FPAAs and that the IRS had erred in determining that the partnerships' activities constituted a series of sham transactions. In order to end their involvement in these suits,[2] Taxpayers

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[2] Ultimately, on July 19, 2001, the Tax Court issued stipulated decisions in the partnership-level proceedings. These decisions found that the adjustments to partnership income and expense were attributable to transactions "which lacked economic substance," as described in former I.R.C. §6621(c)(3)(A)(v), "so as to result in a substantial distortion of [partnership income and/or expense]," as described in I.R.C. §6621(c)(3)(A)(iv). The decisions also determined that the provisions of I.R.C. §6229 did not bar the assessment of deficiencies in income tax attributable to the adjustments to partnership items.

offered to settle with the IRS by executing Forms 870-P(AD) ("Settlement Agreements"), and the IRS accepted these settlements. In the Settlement Agreements, Taxpayers were permitted to report a fraction of the previously disallowed losses, and, in return, Taxpayers agreed that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." The Settlement Agreements made no mention of the "sham transaction" determination in the FPAA, but did specify that the settlements "may result in an additional tax liability to [Taxpayers] plus interest as provided by law." Thereafter, the IRS assessed additional tax and interest, including penalty interest pursuant to §6621(c), which Taxpayers paid in full.

Mr. Keener then filed administrative refund claims with the IRS in December 1999, and the Smiths filed administrative refund claims in March 2002. The IRS denied their claims, and Mr. Keener and the Smiths filed separate refund suits in the Court of Federal Claims, which were later consolidated. Keener, 76 Fed. Cl. at 457. After consolidation, the Government filed partial motions to dismiss, arguing that the Court of Federal Claims lacked jurisdiction under I.R.C. §7422(h). Id. The court granted the Government's motion, id. at 470, and, after the parties stipulated to a dismissal of the remaining issues with prejudice, entered final judgment. Taxpayers

appealed to this court, and we have jurisdiction pursuant to 28 U.S.C. §1295(a)(3).

DISCUSSION

"The Court of Federal Claims' decision to grant the Government's motion to dismiss for lack of jurisdiction is a matter of law, which this court reviews de novo." Mudge v. United States, 308 F.3d 1220, 1224 (Fed. Cir. 2002). As the party seeking the exercise of jurisdiction, Taxpayers have the burden of establishing that jurisdiction exists. Rocovich v. United States, 933 F.2d 991, 993 (Fed. Cir. 1991).

At the Court of Federal Claims, Taxpayers argued that they were entitled to refunds on two separate grounds. First, Taxpayers claimed that they were due refunds of tax and interest on the theory that the IRS assessed the tax and interest after the statute of limitations in I.R.C. §6229(a) expired. Second, and alternatively, Taxpayers claimed that they were due refunds of penalty interest—paid pursuant to I.R.C. §6621(c)—because their underpayments of tax were not attributable to "tax motivated transactions." The Government filed a motion to dismiss, arguing that I.R.C. §7422(h) deprives the Court of Federal Claims of jurisdiction over both of these claims, and the Court of Federal claims agreed, concluding that §7422(h) precluded jurisdiction because the Taxpayers' claims for refunds are "attributable to partnership items."

Keener, 76 Fed. Cl. at 460, 469-70. After providing a brief overview of the relevant law, we evaluate the dismissal of each of Taxpayers' claims in turn.

A. Overview of TEFRA

As partnerships are pass-through entities that do not themselves pay tax, all income, deductions, and credits are allocated to the individual partners. I.R.C. §§701-702; Conway v. United States, 326 F.3d 1268, 1271 (Fed. Cir. 2003). Partnerships are required to file annual information returns reporting the partners' distributive shares of income, gain, deductions or credits, I.R.C. § 6031, and the individual partners then report their distributive shares on their federal income tax returns, I.R.C. §§701-704.

In 1982, Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub. L. No. 97-248, 96 Stat. 324. "TEFRA created a single unified procedure for determining the tax treatment of all partnership items at the partnership level, rather than separately at the partner level." In re Crowell, 305 F.3d 474, 478 (6th Cir. 2002); see AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. United States, 481 F.3d 1351, 1355 (Fed. Cir. 2007) (TEFRA is "a statutory scheme that intends that adjustment to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items."). Accordingly, whether a tax item is a "partnership item" governs

how the TEFRA procedures apply. Significantly for this appeal, the code defines the terms "partnership item," "nonpartnership item," and "affected item" as follows:

> (3) Partnership item.--The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.
>
> (4) Nonpartnership item.--The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.
>
> (5) Affected item.--The term "affected item" means any item to the extent such item is affected by a partnership item.

I.R.C. §6231(a).

B. Statute of Limitations Claim —I.R.C. §6229(a)

Taxpayers first argue that the Court of Federal Claims had jurisdiction over their refund claims that allege that the IRS assessed tax and interest after the statute of limitations in I.R.C. §6229(a) had expired. The Government argues that the

Court of Federal Claims correctly determined that it lacked jurisdiction over Taxpayers' limitations claim because that claim is a challenge to a partnership item and TEFRA specifies that "[n]o action may be brought for a refund attributable to partnership items" (with exceptions not applicable here). I.R.C. §7422(h). In response, Taxpayers assert that this jurisdictional bar does not apply to their limitations claim because it is not a "partnership item."

As this dispute turns on the meaning of the term "partnership item," we look first to its statutory definition:

> The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

Id. at §6231(a)(3) (emphasis added). The relevant Treasury regulation further defines a "partnership item" to include "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b) (emphasis added).

The Government argues that the limitations claim is a "partnership item" within the terms of the regulation because the statute of limitations "underlie[s] the determination of the amount, timing, and characterization of items of income, credit gain, loss, deduction, etc." See Weiner v. United States, 389 F.3d 152, 157 (5th Cir. 2004) ("[T]he treasury regulations have implicitly included the statute of limitations determination within the definition of 'partnership item.'"); Slovacek v. United States, 36 Fed. Cl. 250, 255 (1996) (suggesting that the limitations claim "might be said to affect the amount, timing, and characterization of income, etc., (partnership items) at the partnership level, if only in a thumbs-up or thumbs-down manner"). Taxpayers do not dispute that this regulation includes their limitations claim in its definition of "partnership item."

Rather, Taxpayers argue that the regulation should not be given deference because the regulation's inclusion of the limitations claim in its definition of "partnership item" contradicts the plain language of the statute. See Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843 (1984) (stating that a regulation adopting a "permissible construction" of a statute is due deference "if the statute is silent or ambiguous with respect to the specific issue"). Taxpayers assert that the statute defines the term "partnership item" to include only (1) items found

in subtitle A that (2) must be taken into account for the partnership's taxable year and (3) are designated as "more appropriately determined at the partnership level." While stipulating that their limitations claim satisfies the latter two requirements, Taxpayers argue that the claim cannot be a "partnership item" because it fails to satisfy the first requirement. In other words, Taxpayers contend that because the provisions relevant to this claim—namely, §§6229(a) and 6501—are found in subtitle F of the code, rather than subtitle A, the claim cannot be considered a partnership item by definition. Because the statute is allegedly clear in this regard, Taxpayers argue that the Treasury regulation is invalid to the extent it defines "partnership item" to include any item outside subtitle A.

The ambiguity in the statutory definition, however, is illustrated by Prati v. United States, 81 Fed. Cl. 422 (2008), where the court adopted a different understanding of the statute's definition of "partnership item." Under that court's reading, the statute's phrase I.R.C. §6231(a)(3) (emphasis omitted)). That court's understanding "permits treating, as partnership items, any and all legal issues that influence the treatment of partnership items arising under subtitle A." "under any provision of subtitle A" modifies not "any [partnership] item" (as Taxpayers argue), but what immediately precedes it (i.e., "the partnership's taxable year"). Id. at 430-31 (citing William Strunk

Jr. & E.B. White, The Elements of Style 4-5, 59 (4th ed. 1999) (identifying rule of grammar that a restrictive clause limits or defines what immediately precedes it and is not set-off by a comma)). The court noted that this understanding "makes eminent sense because while subtitle A encompasses substantive rules for a partner's income tax, subtitle A's provisions make clear that this income is derived from the partnership during the partnership's taxable year, as defined by this subtitle." Id. at 431. Under this reading, a "partnership item" would be anything that affects—or, in other words, is "required to be taken into account for"—the partnership's taxable year. Id. (quoting Id. at 432. Also, under this reading a "partnership item" could include items outside subtitle A.

Because we are presented with these different interpretations, we hold that the statute does not unambiguously answer the question of whether a provision outside of subtitle A can be a "partnership item." See GHS Health Maint. Org., Inc. v. United States, 536 F.3d 1293, 1297 (Fed. Cir. 2008) ("Identifying 'the precise question at issue' is a necessary prerequisite to determining whether or not Congress has directly spoken on it."). In light of this ambiguity, we conclude that the Government's interpretation of the statute is, at a minimum, a reasonable one. Since the statute is ambiguous with respect to this issue, we give deference to the agency's interpretation of the

statute. Chevron, 467 U.S. at 843. As noted above, Taxpayers do not dispute that the regulation's definition of "partnership item" includes their limitations claim. Thus, the Court of Federal Claims correctly determined that it lacked jurisdiction over the limitations claim.[3]

We note, moreover, that the interpretation of the statutory language outlined in Prati is more reasonable and appropriate given the structure established by TEFRA. As noted above, TEFRA is "a statutory scheme that intends that adjustment to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items." AD Global Fund, 481 F.3d at 1355. To remain consistent with this structure, the limitations claim raised by Taxpayers should not be litigated in a partner-level proceeding because it affects the partnership as a whole. Weiner, 389 F.3d at 156-57. Moreover, to allow a taxpayer to raise this argument in a

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[3] With this result, we join a "legion" of other courts who, while adopting different rationales, have found that this limitations claim cannot be raised in a partner-level proceeding. Keener, 76 Fed. Cl. at 463 (citing Weiner, 389 F.3d at 156-57; Davenport Recycling Assocs. v. Comm'r of Internal Revenue, 220 F.3d 1255, 1260 (11th Cir. 2000); Williams v. United States, 165 F.3d 30 (6th Cir. 1998) (Table); Kaplan v. United States, 133 F.3d 469, 473 (7th Cir. 1998); Crowell v. Comm'r of Internal Revenue, 102 T.C. 683, 693 (1994)); see also Chimblo v. Comm'r of Internal Revenue, 177 F.3d 119, 125 (2d Cir. 1999).

partner-level proceeding "would undermine TEFRA's dual goals of centralizing the treatment of partnership items and ensuring the equal treatment of partners." Chimblo, 177 F.3d at 125.

In addition, Taxpayers' proffered interpretation of the statutory definition—which categorically excludes anything in subtitles B-J from the definition of "partnership item"—makes little sense given the framework established by TEFRA. Subtitle F of the Code, titled "Procedure and Administration," includes subchapter C, which is titled "Tax Treatment of Partnership Items." (Emphasis added). This subchapter includes rules relating to the treatment of partnership items (e.g., §§6221, 6229, and 6231), and, if we were to adopt Taxpayers' definition of "partnership item," these procedures for dealing with partnership items would not, themselves, be partnership items. The result would be that a partnership-level proceeding would not adjudicate these issues, instead leaving them to a plurality of potentially inconsistent partner-level proceedings. See I.R.C. §6221 ("[T]he tax treatment of any partnership item shall be determined at the partnership level."). Like other courts,[4] we reject this impractical result. See River

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[4] Indeed, as noted above, the Tax Court, when dealing with Taxpayers' partner-level suit, already addressed this limitations claim, albeit after these particular partners settled with the IRS. Agri-Cal Venture Assocs. v. Comm'r of Internal Revenue, 80 T.C.M. (CCH) 295 (2000).

City Ranches # 1 Ltd. v. Comm'r of Internal Revenue, 401 F.3d 1136, 1144 (9th Cir. 2005) ("A partnership's tax items . . . are litigated in partnership proceedings—not in the individual partners' cases.").

C. Penalty Interest Claim—I.R.C. §6621(c)

Second, Taxpayers requested refunds of penalty interest paid pursuant to I.R.C. §6621(c). Section 6621(c), which was in effect for the years at issue,[5] imposed an interest rate of 120% of the statutory rate on "any substantial underpayment attributable to tax motivated transactions." I.R.C. §6621(c)(1).

> [T]he term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A . . . which is attributable to 1 or more tax motivated transactions if the

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[5] Former §6621(c), originally codified I.R.C. §6621(d), was added to the tax code in 1984 and applies to interest accruing after December 31, 1984. Tax Reform Act of 1984, Pub. L. No. 98-369, Div. A, §144, 98 Stat. 494 (adding provision to tax code); Tax Reform Act of 1986, Pub. L. No. 99-514, §1511(c)(1), 100 Stat. 2085 (amending and recodifying). Although this version of §6621(c) was repealed in 1990, it remains applicable for the tax years at issue in this case. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, §11341, 104 Stat. 1388 (specifying amendment and effective date).

> amount of the underpayment . . . exceeds $1,000.

Id. at §6621(c)(2). The statute defines a "tax motivated transaction" to include "any sham or fraudulent transaction." Id. at §6621(c)(3)(A)(v).

In this case, the FPAAs issued by the IRS disallowed the ordinary loss deductions reported by the partnerships and explained that these deductions were "not allowable" for several reasons, including a determination that "[t]he partnership's activities constitute[d] a series of sham transactions." After partner-level suits followed these FPAAs, Taxpayers chose to settle with the IRS. The Settlement Agreements made no mention of the "sham transaction" determinations in the FPAAs and stated that the settlements "may result in an additional tax liability to [Taxpayers] plus interest as provided by law." The IRS later assessed additional tax and interest, including penalty interest pursuant to §6621(c), which Taxpayers paid.

Now arguing that they are entitled to a refund, Taxpayers assert that their underpayments of taxes were not attributable to "tax motivated transactions" and, thus, that the IRS improperly imposed penalty interest under this section. The Government responds that the Court of Federal Claims correctly concluded that it lacks jurisdiction over this claim for a refund because it is "attributable to partnership items." See I.R.C.

§7422(h). Noting that Taxpayers' arguments are focused on determining whether or not the partnerships' transactions were "tax motivated," the Government argues that—because the nature of the partnerships' transactions is a partnership item—Taxpayers' claims are based on the determination of a partnership item. Thus, the Government concludes, Taxpayers' claims are "quintessential claims for a refund 'attributable to partnership items'" and are barred by §7422(h). We agree.

As noted above, §7422(h) provides that "[n]o action may be brought for a refund attributable to partnership items . . . except as provided in section 6228(b) or section 6230(c)." I.R.C. §7422(h) (emphasis added). "The phrase 'attributable to,' . . . is not defined anywhere in the Code and has no special technical meaning under the tax laws. Courts in various tax cases have construed the phrase according to its plain meaning, which is understood to be 'due to, caused by, or generated by.'" Electrolux Holdings, Inc. v. United States, 491 F.3d 1327, 1330-31 (Fed. Cir. 2007) (internal citations omitted) (addressing meaning of the phrase in §6511(d)(2)(A)). Thus, the applicability of §7422(h) turns on whether Taxpayers' refund claims are "due to, caused by, or generated by" a partnership item.

As the Government correctly notes, Taxpayers' refund claims are based on the assertion that the

partnerships' transactions were not shams. This characterization of a partnership's transaction is a partnership item:[6] it bears directly on the validity of the deductions claimed by the partnership; it affects the tax treatment of other partnership item entries; and it can even dictate whether certain income tax concepts are applicable. See I.R.C. §6221 ("[T]he tax treatment of any partnership item shall be determined at the partnership level."); Treas. Reg. §301.6231(a)(3)-1(b) (defining "partnership item" to include "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit gain, loss, deduction, etc."); River City Ranches, 401 F.3d at 1143-44 ("The nature of the partnerships' transactions is . . . 'required to be taken into account . . . under . . . [the income tax

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[6] The Government identifies numerous circuit courts in accord. See, e.g., Nault v. United States, 517 F.3d 2, 8 (1st Cir. 2008) (noting that the court lacked jurisdiction "to determine whether the relevant transactions actually did have economic substance"); RJT Invs. X v. Comm'r of Internal Revenue, 491 F.3d 732, 736-38 (8th Cir. 2007) (status of partnership as a sham is a partnership item); River City Ranches, 401 F.3d at 1143-44; Randell v. United States, 64 F.3d 101, 107-08 (2d Cir. 1995) (court lacked jurisdiction to consider taxpayer's argument that partnership income was a sham). Moreover, Taxpayers do not dispute this characterization and even expressly concede that the nature of a partnership item is a partnership item.

provisions of] subtitle A.'" (alterations in original) (quoting I.R.C. §6231(a)(3))). Moreover, the nature of a partnership's transaction affects all partners and is not dependent on facts unique to a particular partner. Cf. Prochorenko v. United States, 243 F.3d 1359, 1363 (Fed. Cir. 2001) (finding jurisdiction when issue was "entirely dependent on [the taxpayers'] own unique factual circumstances"). Thus, the nature of a partnership's transaction—and, specifically, whether a partnership transaction is a "sham"—is a partnership item.

Accordingly, because Taxpayers are requesting a refund based on the nature of the partnerships' transactions and because the nature of a partnership's transaction is a partnership item, Taxpayers' claims are "attributable to" partnership items. Cf. id. (finding that refund was not "attributable to partnership items" where it was "based on" a nonpartnership item). Accordingly, the Court of Federal Claims correctly determined that it lacks jurisdiction over Taxpayers' claim "for a refund attributable to partnership items." I.R.C. §7422(h).

In an attempt to avoid this result, Taxpayers recharacterize their claims as general claims for a refund of §6621(c) penalty interest—which, they assert, is an affected item and not a partnership item—and argue that §7422(h) does not bar refund claims for affected items. Taxpayers explain that

an affected item—defined by statute as "any item to the extent such item is affected by a partnership item," I.R.C. §6231(a)(5)—includes both a partnership-level component (requiring partnership-level determinations) and a partner-level component (requiring partner-level determinations). Thus, by challenging the penalty interest "as a whole," Taxpayers contend that they can avoid the statute's jurisdictional bar. We are not persuaded.

First, even assuming that penalty interest under §6221(c) is an affected item, Taxpayers only challenge a partnership-level component of this affected item (namely, the nature of the partnerships' transactions), without advancing any argument regarding partner-level components (e.g., a partner's underpayment must exceed $1,000 in order to be "substantial").[7] Second, Taxpayers' argument relies on the mistaken premise that §7422(h) only bars claims for a refund of partnership items. The statute, however, bars refund claims attributable to partnership items. Because the two terms are not coextensive, our inquiry must focus on the language in the statute. See Prochorenko, 243 F.3d at 1363 ("While it is true that the Prochorenkos were seeking a refund

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[7] We, therefore, do not decide whether §7422(h) precludes jurisdiction over every claim for a refund of penalty interest imposed pursuant to §6621(c).

of partnership taxes, their refund was not 'attributable to partnership items.'").

Taxpayers also obliquely suggest that this case is tantamount to the potential situation where the IRS imposes penalty interest when no partnership-level determination has been made that the transactions were tax motivated. Quite simply, this is not that case. Each relevant FPAA disallowed the partnership's deductions because "[t]he partnership's activities constitute[d] a series of sham transactions." Taxpayers concede that the FPAAs are conclusive, as this finding was not altered by the Settlement Agreements. And the statute is clear that a "sham or fraudulent transaction" is a "tax motivated transaction." I.R.C. §6621(c)(3)(A)(v).

More specifically, Taxpayers' argument appears to be that the relevant FPAAs fail to establish that Taxpayers' underpayments were attributable to "tax motivated transactions" because the FPAAs list multiple, independent grounds for the disallowance—some of which qualify as "tax motivated transactions" and others which do not—making it impossible to determine whether Taxpayers' underpayments were "attributable to" the tax motivated grounds. Even assuming that the Court of Federal Claims had jurisdiction over this argument, we would not be persuaded. See Irom v. Comm'r of Internal Revenue, 866 F.2d 545, 547-48 (2d Cir. 1989) (finding that taxpayer should

pay penalty interest for portion of deficiency attributable to a tax motivated transaction even though that deficiency may also be attributable to other factors). The inequitable result of Taxpayers' contention would be to impose penalty interest when a deduction is disallowed because the partnerships' transactions were tax motivated, but not to impose penalty interest when that deduction is also disallowable on other inseparable grounds.

In sum, we conclude that Taxpayers' claims for a refund are barred by I.R.C. §7422(h) because they are based on the nature of the partnerships' transactions.

CONCLUSION

The Court of Federal Claims correctly determined that, under I.R.C. §7422(h), it lacked jurisdiction over: (1) Taxpayers' claims for refunds of tax and interest on the theory that the IRS assessed tax and interest after the statute of limitations in I.R.C. §6229(a) expired; and (2) Taxpayers' claims for refunds of penalty interest, I.R.C. §6621(c), on the grounds that their underpayments of tax were not attributable to "tax motivated transactions."

AFFIRMED

United States Court of Appeals

for the Federal Circuit

2009-5010

WILLIAM H. SCHELL and RUBY G. SCHELL,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Thomas E. Redding, Redding & Associates, P.C., of Houston, Texas, argued for plaintiffs-appellants. With him on the brief were Sallie W. Gladney and Teresa J. Womack.

Bruce R. Ellisen, Attorney, Appellate Section, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With him on the brief were John A. DiCicco, Acting Assistant Attorney General, and Arthur T. Catterall, Attorney.

Appealed from: United States Court of Federal Claims

Judge Susan G. Braden

United States Court of Appeals for the Federal Circuit

2009-5010

WILLIAM H. SCHELL and RUBY G. SCHELL,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 04-CV-1743,

Judge Susan G. Braden.

DECIDED: December 22, 2009

Before LOURIE, ARCHER, and GAJARSA, Circuit Judges.

GAJARSA, Circuit Judge.

William H. Schell and Ruby G. Schell (collectively "Taxpayers") appeal from the decision of the Court of Federal Claims ("trial court") dismissing their complaint that alleged the Internal Revenue Service ("IRS") unlawfully denied their claim for a tax refund for the tax years 1993 and 1995. See Schell v. United States, 84 Fed. Cl. 159 (2008). Because we find that Taxpayers do

not have standing to challenge the actions of the IRS, we affirm the trial court's finding that it lacked jurisdiction over the Taxpayers' refund claims.

BACKGROUND

In the early 1980s, American Agri-Corp, Inc. ("AMCOR") organized a number of limited partnerships and solicited investments from individuals. In the mid-1980s, William H. Schell invested in two limited partnerships offered by AMCOR. Specifically, Mr. Schell held a limited partnership interest in Canyon Desert Vineyards ("CDV") during the tax years 1985-1993 and in Vista Ag-Realty Partners ("VARP") during the tax years 1986-1995. In 1985, CDV reported losses on farming expenses of approximately $7.4 million and $196,000 as "other deductions." Mr. Schell reported his pro rata share of his loss, which totaled $73,811, on his 1985 tax return. In 1986, VARP reported losses on farming expenses of approximately $11.1 million and $291,000 as "other deductions." Mr. Schell reported his pro rata share of his loss, which totaled $69,840, on his 1986 tax return.

After examining the returns of these partnerships, the IRS issued a Notice of Final Partnership Administrative Adjustment ("FPAA") to each partnership, disallowing farming expenses and other deductions. The listed reasons for complete disallowance included the IRS' findings

that "[t]he partnership's activities constitute a series of sham transactions" and "[t]he partnership's activities lack economic substance." Both CDV and VARP filed petitions for readjustment of these findings in the United States Tax Court. CDV and VARP dissolved in 1993 and 1995, respectively.

In April 1997, while CDV and VARP's petitions for readjustment were pending before the Tax Court, the Taxpayers entered into two settlement agreements with the IRS. Under these partner-specific settlement agreements, the $7.6 million net loss reported by CDV in 1985 was reduced by fifty five percent, or approximately $3.4 million. The $11.1 million net loss reported by VARP in 1986 was reduced by fifty percent, or approximately $5.6 million. The settlement agreements made no mention of the "sham transaction" determinations in the FPAAs.

In 1998, the Taxpayers filed an "AMCOR-Related Refund Claim" for the tax year 1995, decreasing their 1995 income from VARP by $9,522. As a result, the IRS refunded $3,930 plus interest. In 1999, the Taxpayers filed a refund claim for the tax year 1993 and a second refund claim for the tax year 1995, claiming that "[a]s a direct consequence of the settlement and the corrections of the erroneous reporting of a termination distribution, there was a substantial basis in the partnership interest and a resulting

loss upon the dissolution and termination of the partnership, which loss is the basis of this claim for refund."

In 2001, the Tax Court issued decisions in the partnership-level proceedings. The decisions found that the adjustments to partnership income and expense were attributable to transactions "which lacked economic substance . . . so as to result in a substantial distortion of [partnership income and/or expense]."

In 2002, the IRS rejected the Taxpayers' second refund claim for the tax year 1995. The IRS also informed the Taxpayers that AMCOR claims are treated as capital losses and it included instructions for claiming these losses. The IRS has not taken any action on the 1993 refund claim.

Instead of resubmitting their claim, the Taxpayers filed a complaint in the trial court, alleging that the IRS unlawfully denied the Taxpayers' claim for a tax refund for the tax years 1993 and 1995. The Taxpayers' theory was that the 1997 settlement agreements increased their basis of the partnership interest by the amount of loss the settlement agreements disallowed. The government filed a motion to dismiss, arguing that the trial court lacked subject matter jurisdiction under I.R.C. §7422(h), or in the alternative, that the Taxpayers failed to state a claim under Court of Federal Claims Rule 12(b)(6). The court granted the government's motion holding that: (1) the

losses identified in the Taxpayers' 1999 tax refund claims concern "partnership items," which the Taxpayers have no standing to pursue under §7422(h); and (2) the exception to §7422(h) under I.R.C. §6230(c)(1)(B) does not apply because the 1997 settlement agreements did not alter the FPAA's findings that the activities of CDV and VAPR were sham transactions and thus did not convert the partnership items into non-partnership items.

The Taxpayers timely appealed to this court. We have jurisdiction to review the final decision of the trial court pursuant to 28 U.S.C. §1295(a)(3).

DISCUSSION

The Court of Federal Claims' decision to grant the government's motion to dismiss for lack of jurisdiction is a matter of law that we review de novo. Mudge v. United States, 308 F.3d 1220, 1224 (Fed. Cir. 2002). As the party seeking the exercise of jurisdiction, the Taxpayers have the burden of establishing that jurisdiction exists. Rocovich v. United States, 933 F.2d 991, 993 (Fed. Cir. 1991).

I.

A partnership is not a taxable entity. Partnerships neither incur tax liability, nor do they pay taxes. Before Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), each partner filed his own tax return reflecting his distributive share of the

partnership's gains and losses, and IRS audited each individual partner in the partnership. As a consequence, the IRS could not guarantee consistent treatment of a partnership item for each partner in a partnership. To address this concern, TEFRA was enacted and the treatment of partnership items is now resolved in a unified partnership-level proceeding. See I.R.C. §6221 (2006). Partnerships are required to file informational returns reflecting the distributive shares of income, gains, deductions, and credits attributable to their partners, while individual partners are responsible for reporting their pro rata share of tax on their income tax returns. See I.R.C. §701.

TEFRA defines three types of items: "partnership item," "nonpartnership item," and "affected item." "Partnership item" generally encompasses items "required to be taken into account for the partnership's taxable year," and those "more appropriately determined at the partnership level than at the partner level." I.R.C. §6231(a)(3). Such items include the income, gains, losses, deductions, and credits of a partnership. Treas. Reg. §301.6231(a)(3)-1(a) (2009). The term also includes "the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing and characterization of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b). "Nonpartnership items" are those items that are

not partnership items, and an "affected item" is defined as "any item to the extent such item is affected by a partnership item." I.R.C. §6231(a)(4)-(5). An example of an "affected item" is a partner's tax basis in his partnership interest, which is affected by partnership items such as partnership income or loss.

If the IRS decides to adjust any "partnership items" reflected on the partnership's return, it must notify the individual partners of the adjustment through a FPAA. See I.R.C. §6223. For ninety days after a FPAA issues, the tax matters partner has the exclusive right to challenge the proposed adjustments in United States Tax Court, the Court of Federal Claims, or a United States District Court. I.R.C. §6226(a).

At the partner level, a partner may contest the tax liability by paying the assessment and filing a refund action in the Court of Federal Claims. I.R.C. §6226(e). However, TEFRA limits a partner's ability to seek a refund based on adjustments made to the partnership's return by depriving all courts of jurisdiction to hear partner refund claims where the refund is "attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)." I.R.C. §7422(h).

Alternatively, a partner may choose to settle his individual tax liability with the IRS. I.R.C. §6224. When a partner chooses to settle his individual tax

liability with the IRS, that partner would no longer participate in the partnership level proceeding, and instead would be bound by the terms of his settlement agreement. See I.R.C. §6224. If the IRS enters into a settlement agreement with any partner with respect to partnership items, other partners are entitled to a consistent settlement as to those partnership items. I.R.C. §6224(c)(2).

II.

The Taxpayers argue that their 1999 refund claims are not barred by §7422(h) because they are not attributable to partnership items; and even if they are, the §6230(c)(1)(B) exception to the §7422(h) jurisdictional bar should apply.

Specifically, the Taxpayers argue that their refund claims are not barred by §7422(h) because they are attributable to the loss of Schell's tax basis in his partnership interests upon termination of the partnerships. The government does not dispute that the Taxpayers' basis in their partnership interest is not a partnership item. Instead, the government argues that the Taxpayers' refund claims are "attributable to partnership items." See I.R.C. §7422(h) (emphasis added). This court has held that the applicability of §7422(h) turns on whether the Taxpayers' refund claims are "due to, caused by, or generated by" a partnership item. Keener v. United States, 551 F.3d 1358, 1365 (Fed. Cir. 2009) (quoting

Electrolux Holdings, Inc. v. United States, 491 F.3d 1327, 1331 (Fed. Cir. 2007).

It is widely accepted that a transaction that lacks economic substance is not recognized for federal income tax purposes. See id. at 1365; see also Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1353-54 (Fed. Cir. 2006); Lerman v. Comm'r, 939 F.2d 44, 45 (3d Cir. 1991) (stating that a transaction that "is devoid of economic substance . . . simply is not recognized for federal taxation purposes"); Kirchman v. Comm'r, 862 F.2d 1486, 1490 (11th Cir. 1989); Salley v. Comm'r, 464 F.2d 479, 483 (5th Cir. 1972); Winn-Dixie Stores, Inc. v. Comm'r, 113 T.C. 254, 278 (1999) (stating that "denial of recognition means that such a transaction cannot be the basis for a deductible expense"). Thus, a sham transaction, devoid of economic substance, cannot be the basis for a deductible loss. Therefore, the Taxpayers' refund claims are based on the assertion that the partnerships' transactions were not shams. This court has previously held that the question of whether a partnership transaction is a "sham" is a "partnership item." Keener, 551 F.3d at 1365-66. Accordingly, the Taxpayers' claims are "attributable to" partnership items and the trial court correctly determined that it lacked jurisdiction over the Taxpayers' refund claims.

The Taxpayers also argue that the §6230(c)(1)(B) exception to the §7422(h)

jurisdictional bar should apply. Section 6230(c)(1)(B) provides an exception to §7422(h):

> A partner may file a claim for refund on the grounds that . . . the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).

When a partner chooses to settle his individual tax liability with the IRS, the settling individual's partnership items are converted to non-partnership items, but only when the IRS enters into a settlement agreement with the partner with respect to such items. See I.R.C. §6231(b)(1)(C) ("[T]he partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date . . . the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner with respect to such items . . . .") (emphasis added). Thus, when a partner files an action for a refund attributable to partnership items that have been converted through a settlement agreement, the jurisdictional bar of §7422(h) no longer applies. See id.

The Taxpayers argue that, even if their claims are attributable to partnership items, the IRS "failed

to allow credit or make a refund . . . attributable to the application to the partner" of the 1997 settlement agreements. They argue that the 1997 settlement agreements effectively determined that the partnerships' transactions were not shams, and the sham-transaction issue was converted to non-partnership item under §6231(b)(1)(C).

It is undisputed that the 1997 settlement agreements did not explicitly address the sham-transaction issue. The Taxpayers argue, however, that the IRS implicitly conceded that the partnerships' transactions were not shams because: (1) §6224(c) settlements are comprehensive; and (2) the IRS allowed partial deductions, whereas no deduction is allowed for sham transactions. Both of these arguments are without merit. The Taxpayers' argument that all §6224(c) settlements are comprehensive stems from a regulation that reads, "[s]ettlements shall be comprehensive, that is, a settlement may not be limited to elected items." Temporary Regulations, 52 Fed. Reg. 6779, 6787 (Mar. 5, 1987) (issuing Temporary Regulation §301.6224(c)-3T(b)). As the government correctly notes, however, the cited regulation does not require that every §6224(c) settlement be "comprehensive"; rather, it requires that, to obtain a consistent settlement, a partner who enters into a settlement agreement must agree to all the terms that were in the settlement agreement that the IRS previously entered into with other partners. See Keener v. United States,

76 Fed. Cl. 455, 465 (2007), aff'd, 551 F.3d 1358 (Fed. Cir. 2009). In addition, the Taxpayers' argument that the IRS implicitly conceded that the partnerships' transactions were not shams by allowing partial deductions is wholly without merit. The fact that the IRS chose to settle does not follow that it conceded that the transactions were not shams. In addition, that the FPAAs listed "sham transaction" as one of several grounds for disallowing partnership does not, as the Taxpayers suggest, render the FPAAs less conclusive. Keener, 551 F.3d at 1366.

CONCLUSION

Because the 1997 settlement agreement did not change the FPAA's findings that the activities of CDV and VARP were sham transactions, the sham-transaction issue was not converted into a non-partnership item, and the Taxpayers' refund claims necessarily involve resolution of "partnership items." Accordingly, the Taxpayers do not have standing to seek adjudication, and the trial court correctly determined that it lacked jurisdiction over the Taxpayers' refund claims.

AFFIRMED

COSTS

Costs to the Appellee.

INTERNAL REVENUE CODE (26 U.S.C.)

SEC. 165. LOSSES

(a) GENERAL RULE.–There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * * *

SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL

Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level.

SEC. 6223. NOTICE TO PARTNERS OF PROCEEDINGS.

(a) SECRETARY MUST GIVE PARTNERS NOTICE OF BEGINNING AND COMPLETION OF ADMINISTRATIVE PROCEEDINGS.—The Secretary shall mail to each partner whose name and address is furnished to the Secretary notice of—

* * * *

(2) the final partnership administrative adjustment resulting from any such proceeding.

* * * *

(d) PERIOD FOR MAILING NOTICE.—

* * * *

(2) NOTICE OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENT.—The Secretary shall mail the notice specified in paragraph (2) of subsection (a) to each partner entitled to such notice not later than the 60th day after the day on which the notice specified in such paragraph (2) was mailed to the tax matters partner.

* * * *

SEC. 6224. PARTICIPATION IN ADMINISTRATIVE PROCEEDINGS; WAIVERS; AGREEMENTS.

* * * *

(c) SETTLEMENT AGREEMENT.—In the absence of a showing of fraud, malfeasance, or misrepresentation of fact—

(1) BINDS ALL PARTIES.—A settlement agreement between the Secretary and 1 or more partners in a partnership with respect to the determination of partnership items for any partnership taxable year shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year. . . .

(2) OTHER PARTNERS HAVE RIGHT TO ENTER INTO CONSISTENT AGREEMENTS.—If the Secretary enters into a settlement agreement with any partner with respect to partnership items for any partnership taxable year, the Secretary shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such settlement agreement. . . .

(3) TAX MATTERS PARTNER MAY BIND CERTAIN OTHER PARTNERS.—

(A) IN GENERAL.—A partner who is not a notice partner (and not a member of a notice group described in subsection (b)(2) of section 6223) shall be bound by any settlement agreement—

(i) which is entered into by the tax matters partner, and

(ii) in which the tax matters partner expressly states that such agreement shall bind the other partners.

* * * *

SEC. 6225. ASSESSMENTS MADE ONLY AFTER PARTNERSHIP LEVEL PROCEEDINGS ARE COMPLETED.

(a) RESTRICTION ON ASSESSMENT AND COLLECTION.—Except as otherwise provided in this subchapter, no assessment of a deficiency attributable to any partnership item may be made (and no levy or proceeding in any court for the collection of any such deficiency may be made, begun, or prosecuted) before—

(1) the close of the 150th day after the day on which a notice of a final partnership administrative adjustment was mailed to the tax matters partner, and

(2) if a proceeding is begun in the Tax Court under section 6226 during such 150-day period, the decision of the court in such proceeding has become final.

* * * *

SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS

(a) PETITION BY TAX MATTERS PARTNER.—Within 90 days after the day on which a notice of a final partnership administrative adjustment is mailed to the tax matters partner,

the tax matters partner may file a petition for a readjustment of the partnership items for such taxable year with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the Claims Court.

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER—

(1) IN GENERAL.—If the tax matters partner does not file a readjustment petition under subsection (a) with respect to any final partnership administrative adjustment, any notice partner (and any 5-percent group) may, within 60 days after the close of the 90-day period set forth in subsection (a), file a petition for a readjustment of the partnership items for the taxable year involved with any of the courts described in subsection (a).

* * * *

(5) TAX MATTERS PARTNER MAY INTERVENE.—The tax matters partner may intervene in any action brought under this section.

* * * *

(c) PARTNERS TREATED AS PARTIES.—If an action is brought under subsection (a) or (b) with respect to a partnership for any partnership taxable year—

(1) each person who was a partner in such partnership at any time during such year shall be treated as a party to such action, and

(2) the court having jurisdiction of such action shall allow each such person to participate in the action.

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

(2) TO FILE PETITION.—No partner may file a readjustment petition under subsection (b) unless such partner would (after the application of paragraph (1) of this subsection) be treated as a party to the proceeding.

* * * *

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates and the proper allocation of such items among the partners.

(g) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. With respect to the partnership, only the tax matters partner, a notice partner, or a 5-percent group may seek review of a determination by a court under this section.

(h) EFFECT OF DECISION DISMISSING ACTION.—If an action brought under this section is dismissed (other than under paragraph (4) of subsection (b)), the decision of the court dismissing the action shall be considered as its decision that the notice of final partnership administrative adjustment is correct, and an appropriate order shall be entered in the records of the court.

SEC. 6228. JUDICIAL REVIEW WHERE ADMINISTRATIVE ADJUSTMENT REQUEST IS NOT ALLOWED IN FULL.

(a) REQUEST ON BEHALF OF PARTNERSHIP.—

* * * *

(4) PARTNERS TREATED AS PARTY TO ACTION.—

* * * *

(B) PARTNERS MUST HAVE INTEREST IN OUTCOME.—For purposes of subparagraph (A), rules similar to the rules of paragraph (1) of section 6226(d) shall apply.

* * * *

SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

(2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.—

(A) Subchapter B shall apply to any deficiency attributable to—

(i) affected items which require partner level determinations, or

(ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) and are described in section 6231(e)(1)(B).

* * * *

(c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.—

(1) IN GENERAL.—A partner may file a claim for refund on the grounds that—

* * * *

(B) the Secretary failed to allow a credit or to make a refund to the partner in the

amount of the overpayment attributable to the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).

* * * *

(4) NO REVIEW OF SUBSTANTIVE ISSUES.—For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the settlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive.

* * * *

(l) COURT RULES.—Any action brought under any provision of this subchapter shall be conducted in accordance with such rules of practice and procedure as may be prescribed by the Court in which the action is brought.

SEC. 6231. DEFINITIONS AND SPECIAL RULES

(a) DEFINITIONS.—For purposes of this subchapter—

* * * *

(3) PARTNERSHIP ITEM.—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

(4) NONPARTNERSHIP ITEM.—The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.

(5) AFFECTED ITEM.—The term "affected item" means any item to the extent such item is affected by a partnership item.

(6) COMPUTATIONAL ADJUSTMENT.—The term "computational adjustment" means the change in the tax liability of a partner which properly reflects the treatment under this subchapter of a partnership item. . . . .

(7) TAX MATTERS PARTNER.—The tax matters partner of any partnership is—

(A) the general partner designated as the tax matters partner as provided in regulations, or

(B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership at the close of the taxable year involved (or, where there is more than 1 such partner, the 1 of such partners whose name would appear first in an alphabetical listing).

If there is no general partner designated under subparagraph (A) and the Secretary determines that it is impracticable to apply subparagraph (B), the partner selected by the Secretary shall be treated as the tax matters partner.

* * * *

(b) ITEMS CEASE TO BE PARTNERSHIP ITEMS IN CERTAIN CASES.—

(1) IN GENERAL.—For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date—

* * * *

(C) the Secretary enters into a settlement agreement with the partner with respect to such items, or

* * * *

(c) REGULATIONS WITH RESPECT TO CERTAIN SPECIAL ENFORCEMENT AREAS.—

(1) APPLICABILITY OF SUBSECTION.—This subsection applies in the case of—

* * * *

(E) other areas that the Secretary determines by regulation to present special enforcement considerations.

(2) ITEMS MAY BE TREATED AS NONPARTNERSHIP ITEMS.—To the extent that the Secretary determines and provides by regulations that to treat items as partnership items will interfere with the effective and efficient enforcement of this title in any case described in paragraph (1), such items shall be treated as non-partnership items for purposes of this subchapter.

* * * *

SEC. 6621. DETERMINATION OF RATE OF INTEREST

* * * *

(c) INTEREST ON SUBSTANTIAL UNDERPAYMENTS ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—

(1) IN GENERAL.—In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the rate of interest established under this section shall be 120 percent of the underpayment rate established under this subsection.

(2) SUBSTANTIAL UNDERPAYMENT ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—For purposes of this subsection, the term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.

(3) TAX MOTIVATED TRANSACTIONS.—

(A) In general.—For purposes of this subsection, the term "tax motivated transaction" means—

(i) any valuation overstatement (within the meaning of section 6659(c)),

(ii) any loss disallowed by reason of section 465(a) and any credit disallowed under section 46(a)(8),

(iii) any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092),

(iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period, and

(v) any sham or fraudulent transaction.

* * * *

SEC. 7422. CIVIL ACTIONS FOR REFUND

(a) No suit prior to filing claim for refund.--No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

* * * *

(h) Special rule for actions with respect to partnership items.—No action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c).

JUDICIARY AND JUDICIAL PROCEDURE

(28 U.S.C.)

§1346. UNITED STATES AS DEFENDANT

(a) The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.

* * * *

§1491. CLAIMS AGAINST UNITED STATES GENERALLY; ACTIONS INVOLVING TENNESSEE VALLEY AUTHORITY

(a)(1) The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. For the purpose of this

paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.

(2) To provide an entire remedy and to complete the relief afforded by the judgment, the court may, as an incident of and collateral to any such judgment, issue orders directing restoration to office or position, placement in appropriate duty or retirement status, and correction of applicable records, and such orders may be issued to any appropriate official of the United States. In any case within its jurisdiction, the court shall have the power to remand appropriate matters to any administrative or executive body or official with such direction as it may deem proper and just. The Court of Federal Claims shall have jurisdiction to render judgment upon any claim by or against, or dispute with, a contractor arising under section 10(a)(1) of the Contract Disputes Act of 1978, including a dispute concerning termination of a contract, rights in tangible or intangible property, compliance with cost accounting standards, and other nonmonetary disputes on which a decision of the contracting officer has been issued under section 6 of that Act.

[(3) Repealed. Pub.L. 104-320, §12(a)(2), Oct. 19, 1996, 110 Stat. 3874]

Federal Regulations

Effective for the Tax Years in Issue

Treas. Reg. §301.6224(c)-3T CONSISTENT SETTLEMENTS (Temporary).

(a) IN GENERAL. If the Service enters into a settlement agreement with any partner with respect to partnership items, the Service shall offer to any other partner who so requests in accordance with paragraph (c) of this section settlement terms which are consistent with those contained in the settlement agreement entered into.

(b) REQUIREMENTS FOR CONSISTENT SETTLEMENTS. "Consistent" settlement terms are those based on the same determinations with respect to partnership items. Settlements with respect to partnership items shall be self-contained; thus, a concession by one party with respect to a partnership item may not be based upon a concession by the other party with respect to a nonpartnership item. Settlements shall be comprehensive, that is, a settlement may not be limited to selected items. The requirement for consistent settlement terms applies only if—

(1) The items were partnership items for the partner entering into the original

settlement immediately before the original settlement, and

(2) The items are partnership items for the partner requesting the consistent settlement at the time the partner files the request.

* * * *

Tax Court Rules

RULE 245. INTERVENTION AND PARTICIPATION

(a) Tax Matters Partner: The tax matters partner may intervene in an action for readjustment of partnership items brought by another partner or partners by filing a notice of election to intervene with the Court. . . . . See Code sec. 6226(b)(2); Rule 241(d)(3).

(b) Other Partners: Any other partner who satisfies the requirements of Code §6226(d) or 6228(a)(4)(B) may participate in the action by filing a notice of election to participate with the Court. . . .

RULE 247. PARTIES

(a) In General: For purposes of this title of these Rules, the Commissioner, the partner who filed the petition, the tax matters partner, and each person who satisfies the requirements of Code

§6226(c) and (d) or 6228(a)(4) shall be treated as parties to the action.

(b) Participating Partners: Participating partners are the partner who filed the petition and such other partners who have filed either a notice of election to intervene or a notice of election to participate in accordance with the provisions of Rule 245. See Code §§6226(c), 6228(a)(4)(A).

RULE 248. SETTLEMENT AGREEMENTS

* * * *

(b) Settlement or Consistent Agreements Entered Into by All Participating Partners or No Objection by Participating Partners:

(1) After the expiration of the time within which to file a notice of election to intervene or to participate under Rule 245(a) or (b), the Commissioner shall move for entry of decision, and shall submit a proposed form of decision with such motion, if—

* * * *

(B) the tax matters partner (if a participating partner) agrees to the proposed decision in the case but does not certify that no party objects to the granting of the Commissioner's motion for entry of decision.

* * * *

(c) Other Settlement and Consistent Agreements: If a settlement agreement or consistent agreement is not within the scope of paragraph (b) of this Rule, then—

(1) in the case of a participating partner, the Commissioner shall promptly file with the Court a notice of settlement agreement or notice of consistent agreement, whichever may be appropriate, that identifies the participating partner or partners who have entered into the settlement agreement or consistent agreement;

. . . .

UNITED STATES TAX COURT

AGRI-CAL VENTURE ASSOCIATES, FREDERICK H. BEHRENS, Tax Matters Partner,	)	
Petitioner,	)	
	)	Docket No. 12530-90
v.	)	Judge Halpern
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to Rule 248(b) of the Tax Court Rules of Practice and Procedure and Respondent's Motion for Entry of Decision, it is

ORDERED AND DECIDED: That the following statement shows the adjustments to the partnership items of Agri-Cal Venture Associates for the taxable year 1986, as set forth below:\

1986 Year

ADJUSTMENTS TO ORDINARY INCOME:

Partnership Item	As Reported	As Determined
Farming Expense Schedule F	$32,181,001.00	$16,081,646.00

Other Deductions	$ 634,885.00	$ 634,885.00
Capital Contributed during the year	$12,660,000.00	$12,660,000.00
Liabilities	$27,607,878.00	$ 4,391,130.00

TAX PREFERENCE ITEMS:

Partnership Item	As Reported	As Determined
Qualified Investment Expense	$30,428,782.00	$ 5,781,469.00

[Page 2]

That the foregoing adjustments to partnership income and expense are attributable to transactions which lacked economic substance, as described in former I.R.C. §6621(c)(3)(A)(v), so as to result in a substantial distortion of income and expense, as described in I.R.C. §6621(c)(3)(A)(iv), when computed under the partnership's cash receipts and disbursements method of accounting; and

That liabilities in the mount of $23,216,748 lack economic substance.

/s/ James S. Halpern, rz

Judge

Entered: JUL 19 2001

FORM 870-P(AD) (5-88)	DEPARTMENT OF THE TREASURY	IN REPLY
	INTERNAL REVENUE SERVICE	REFER TO
DATE 12-20-96	SETTLEMENT AGREEMENT	MS 4550
	FOR PARTNERSHIP ADJUSTMENTS	122096-0032

TAXPAYER(S) NAME(S) AND ADDRESS	NAME OF PARTNERSHIP
Elwood J and Janice L LeBlanc	Agri-Cal Ventures Associates
XXXXXXXXXXXXXXXXXXXX	TIN XX-XXXXXXX
XXXXXXXXXXXXXXXXXXXX	TAX YEAR ENDED 1986
TIN XXX-XX-XXXX	

UNDER THE PROVISIONS OF SECTION 6224(C) OF THE INTERNAL REVENUE CODE, THE UNDERSIGNED OFFERS TO ENTER INTO A SETTLEMENT WITH RESPECT TO THE DETERMINATION OF PARTNERSHIP ITEMS OF THE PARTNERSHIP FOR THE YEAR SHOWN ON THE ATTACHED SCHEDULE OF ADJUSTMENTS. THE UNDERSIGNED, IN ACCORDANCE WITH THE PROVISIONS OF SECTION 6224(B) OF THE CODE, ALSO OFFERS TO WAIVE THE RESTRICTIONS ON THE ASSESSMENT AND COLLECTION OF ANY DEFICIENCY ATTRIBUTABLE TO PARTNERSHIP ITEMS (WITH INTEREST AS REQUIRED BY LAW) PROVIDED IN SECTION 6225(a).

THIS OFFER IS SUBJECT TO ACCEPTANCE FOR THE COMMISSIONER OF THE INTERNAL REVENUE SERVICE. IT WILL TAKE EFFECT AS A WAIVER OF RESTRICTIONS ON THE DATE IT IS ACCEPTED. UNLESS AND UNTIL IT IS ACCEPTED, IT WILL HAVE NO FORCE OR EFFECT.

IF THIS OFFER IS ACCEPTED FOR THE COMMISSIONER, THE TREATMENT OF PARTNERSHIP ITEMS UNDER THIS AGREEMENT WILL NOT BE REOPENED IN THE ABSENCE OF FRAUD, MALFEASANCE, OR MISREPRESENTATION OF FACT; AND NO CLAIM FOR REFUND OR CREDIT BASED ON ANY CHANGE IN THE TREATMENT OF PARTNERSHIP ITEMS MAY BE FILED OR PROSECUTED.

SIGNATURE OF TAXPAYER	DATE
/s/ Elwood J. LeBlanc, Jr.	4-10-00
SIGNATURE OF TAXPAYER	DATE

/s/ Janice L. LeBlanc 4-10-00

CONSISTENT AGREEMENT

IF THIS OFFER IS EXECUTED BY A TAX MATTERS PARTNER, PLEASE INCLUDE TITLE WITH THE SIGNATURE.

NOTE: THE EXECUTION AND FILING OF THIS OFFER WILL EXPEDITE THE ADJUSTMENT OF TAX LIABILITY.

IF THIS OFFER IS EXECUTED WITH RESPECT TO A YEAR FOR WHICH A JOINT RETURN OF A HUSBAND AND WIFE WAS FILED, IT MUST BE SIGNED BY BOTH SPOUSES, UNLESS ONE SPOUSE, ACTING UNDER POWER OF ATTORNEY, SIGNS AS AGENT FOR THE OTHER.

IF THE TAXPAYER IS A CORPORATION, THE OFFER MUST BE SIGNED WITH THE CORPORATE NAME FOLLOWED BY THE SIGNATURE AND TITLE OF THE OFFICER AUTHORIZED TO SIGN.

THIS OFFER MAY BE EXECUTED BY THE TAXPAYER'S ATTORNEY OR AGENT PROVIDED THIS ACTION IS SPECIFICALLY AUTHORIZED BY A POWER OF ATTORNEY, WHICH, IF NOT PREVIOUSLY FILED, MUST ACCOMPANY THIS FORM.

THE SUBMISSION OF THIS OFFER BY YOU AND THE ACCEPTANCE OF THE OFFER FOR THE COMMISSIONER MAY RESULT IN AN ADDITIONAL TAX LIABILITY TO YOU PLUS INTEREST AS PROVIDED BY LAW. IF THE RESULT IS A DECREAS IN TAX, THE AMOUNT OF THE DECREASE WILL BE SENT TO YOU WITH INTEREST AS PROVIDED BY LAW.

FOR INTERNAL REVENUE USE ONLY	DATE ACCEPTED FOR THE COMMISSIONER	SIGNATURE
	JUN 16 2000	/s/ <illegible>
	OFFICE	TITLE
	So. Calif. Appeals	Associates Chief Appeals

FORM 870-P(AD) (5-88)

Settlement Agreement For Partnership Adjustments

Schedule of Adjustments

Name of Partnership AGRI-CAL VENTURE ASSOCIATES Taxpayer Identifying Number XX-XXXXXXX	November 30, 1986		
Detail of Adjustments to Ordinary Income			
Net Farm Profit (Loss)	16,869,368		
Other Deductions	332,808		
Total Adjustments to Ordinary Income	17,202,176	0	0
Other Adjustments T P I - Qualified Investment Expense			
(1) Adjustment	(22,851,641)		
(2) As Reported	31,738,390		
(3) Corrected	8,886,749	0	0
Other Adjustment			
(1) Adjustment	0		
(2) As Reported			
(3) Corrected	0	0	0
Other Adjustment			
(1) Adjustment	0		
(2) As Reported			
(3) Corrected	0	0	0

Remarks

Internal Revenue Service

memorandum

CC:WR:RMC:DEN:TL-12532-90

AMHarbutte

date: January 6, 2000

to: Ogden Service Center, TEFRA Technical Unit
attn: Diana Anderson
Kansas City Service Center,
Exam Support: TEFRA
attn: Jeanette Price

from: Regional Counsel, Western Region
Alice M. Harbutte,
Special Trial Attorney, Denver

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subject: Project Partnership: AMCOR
Subject: 6230(c) Claims for Refund
and 6404(e) abatement
of interest

The purpose of this memorandum is to address some of the issues set forth in the refund claims that are currently being filed by the various Project partnership investors. We have been advised by the TEFRA Service Centers that approximately 2,000 such claims have been received to date. These claims encompass the following four issues: 1) adjustments to basis of a partnership interest, ...

ISSUES

* * * *

2. Whether the Service should deny the Project investor's request for refund attributable to an adjustment in the basis of his partnership interest ["Basis" claim] . . . .

* * * *

Each of the different types of claims are discussed separately below.

"Basis" claim: Issue 2

The "basis" claims fall within the exception provided for at I.R.C. §6230(c)(1)(B). This section provides that a partner may file a claim for refund on the grounds that the Secretary failed to allow a credit or make a refund to a partner "attributable to" the application to the partner of a settlement.

Time for Filing "Basis" Claim:

Under the provisions of §6230(2)(B) as it pertains transcript of account "basis" claim, the statute provides that any claim under paragraph (1)(B) shall be filed within 2 years after the date the settlement was entered into. I.R.C. §6230(c)(2)(B)(i). Therefore, any claim requesting a refund with respect to gain that was reported by a Project investor on a Form 1040, for the year this investor sold his Project partnership interest (or otherwise disposed of such interest) must be filed

within 2 years from the date the Form 870-P(AD) was signed on behalf of the Commissioner.

Merits of "Basis" Claim:

After whether or not a claim involving a basis adjustment was timely filed, the merits of the claim may then be looked at.

Under the terms of the Appeals settlement, the settled partner was required to report additional taxable income. This income was the result of the disallowance of a partion of the original partnership loss claimed by each partner. Therefore, the "basis" claim is "attributable to" the settlement of the partnership items and is allowable under I.R.C. §6230(c)(1)(B). Thus, a refund is proper, to the extent the taxpayer can substantiate the change to their basis in the partnership.

Substantiation of "Basis" Claim:

The Project investor must have settled their partnership items and must have paid the additional amount of tax required under the settlement. Proof that the investor entered into a settlement is the fully executed Form 870-P(AD). The Form 870-P(AD) will shoe the year for which the additional liability was agreed to. The individual investor's transcript of account for this taxable year should show the assessment of tax being made as a result of a computational adjustment relating to the Form 870-P(AD). The

partner's basis will be increased, under the provisions of I.R.C. 705, by the amount his taxable income was increased as a result of the settlement. To determine this amount, the computational adjustment, supporting schedules and the final computation that was mailed to the investor by the Service Center should be obtained.

* * * *

CONCLUSIONS

If the "basis" claim is the only refund claim relating to the Project partnership being made by the investor, then the claim should be allowed after substantiation is provided. However, if this investor has filed other claims for refund relating to the same partnership, then these other claims must first be resolved before processing any refund. The reason for this is that the other related claims may affect the calculation of the partner's basis.

AMCOR CLAIM INSTRUCTIONS

A claim may be filed to reflect the increase in your basis due to the sale of the partnership interest. In addition to the appropriate form, please send a copy of the tax return for the year in which the sale of the partnership interest was reported. If there is a capital loss carryover issue (you reported a $3,000 loss on Schedule D), we will need a claim for the year(s) that the loss was carried to. Include a copy of any examination reports that reflect the amount of losses disallowed or income increased.

In order to identify the claim as "AMCOR", **please annotate the top of the 1040X** with the following:

AMCOR Claim - forward to TEFRA Operations Stop 639

Send claims to:

BIRSC
PO Box 630
Holtsville NY 11742
Attn: TEFRA Operations
Stop 639

Case 10-20425 Document 00511407158 Page 1 Date Filed: 03/10/2011

REDDING & ASSOCIATES, P.C.
Attorneys at Law
2914 West T.C. Jester
Houston, Texas 77018-7010
Telephone: (713) 965-9244 · Telecopier: (713) 621-5227

Thomas E. Redding, J.D. Teresa J. Womack, J.D.
Sallie W. Gladney, J.D.

March 10, 2011

Lyle W. Cayce, Clerk
United States Court of Appeals
for the Fifth Circuit
600 S. Maestri Place, Room 102
New Orleans, LA 70130

Re: *Sharon Scott, Ind. Executrix of the Est. of Edward O. Matthews, et al. v. United States of America*; Docket No. 10-20425

Dear Mr. Cayce:

This case is tentatively calendared for oral argument for the week of April 25, 2011.

I write pursuant to Fed. R. App. P. 28(j), to inform the Court that on March 1, 2011, the Supreme Court issued *Henderson v. Shinseki*, 2011 WL 691592 (U.S.), unanimously reversing and remanding 589 F.3d 1201 (Fed.Cir. 2009) (*en banc*), copy attached. *Henderson* (i) extends the Supreme Court's general analysis in *Arbaugh*[1]

---

[1] *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006).

(addressing Article III courts) to Article I courts, and then (ii) articulates four factors courts must apply to determine whether a provision within a complex procedural framework has "jurisdictional consequences" or is merely a "claim-processing rule" that courts may equitably ignore. *Henderson* directly applies to two of the fundamental issues presented here.

First, it applies to whether 26 U.S.C. §6226(d)(1)(B) is jurisdictional in TEFRA partnership-level Tax Court suits for pre-1997 tax years. (See pp. 29-30, 46-53 of Appellant's Opening Brief and pp.1, 17-23, 29-30 of Appellant's Reply Brief). Under the *Henderson* factors, it is; therefore, because his assessment deadline expired before the partnership-level Tax Court suit was filed, Matthews could never have participated there to raise his limitations defense to assessment.

Second, *Henderson* applies to the effect of conflating

(i) §7422(h) (no jurisdiction over the claim if refund is attributable to partnership items) and

(ii) §6221 (no jurisdiction over the merits of partnership-item elements if refund is attributable to affected items)

by both

(a) the district court below (Article III court), and

(b) the Court of Federal Claims (Article I court) and the Federal Circuit in *Keener* and *Prati*.[2]

(See pp. 14,20-21, and 45 of Appellant's Opening Brief and pp.9-12 of Appellant's Reply Brief). *Arbaugh* held "such unrefined dispositions [are] 'drive-by jurisdictional rulings' that [are] accorded 'no precedential effect' on the question whether the federal court had authority to adjudicate the claim in suit."[3] *Arbaugh* relied on *Steel*, which also rejected such "hypothetical judgments."[4]

Because the nature of these issues, as applied to this partnership tax case, are so complex, on or before March 18, 2011, Appellants will file a motion for leave to file a supplemental brief and a proposed supplemental brief addressing these issues. Appellants do *not* believe that oral argument should be delayed, as there will be sufficient time for the government to respond and

---

[2] *Keener v. U.S.*, 551 F.3d 1358 (Fed.Cir. 2009) and *Prati v. U.S.*, 603 F.3d 1301 (Fed.Cir. 2010).

[3] *Arbaugh*, 546 U.S. at 1242-43, quoting *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 91 (1998).

[4] *Steel*, 523 U.S. at 91.

for this Court to review these additional materials before April 25, 2011.

Very truly yours,
REDDING & ASSOCIATES, P.C.

/s/ Sallie W. Gladney
Sallie W. Gladney,
Attorney for Appellants

SWG:jr
Attachment

U.S. Department of Justice
Tax Division

Please reply to Appellate Section

Facsimile No. (202) 514-8456
Telephone No. (202) 514-3361

P.O. Box 502
Washington, D.C. 20044

EPDelSole
5-74-13292
CMN 2001101347

March 11, 2011

Lyle W. Cayce, Esquire
Clerk, U.S. Court of Appeals
for the Fifth Circuit
600 S. Maestri Place, Room 102
New Orleans, LA 70130

Re: Sharon Scott, et al. v. United States
(5th Cir. - No. 10-20425)

Dear Mr. Cayce:

We are writing in response to the appellant's March 10, 2011 letter pursuant to Rule 28(j) in the above-listed appeal, calling the Court's attention the Supreme Court's March 1, 2011 decision in *Henderson v. Shinseki*, 2011 WL 691592. In *Henderson*, the Court held that a rule regarding the time for appealing an adverse administrative ruling regarding veterans' benefits to the Court of Appeals for Veterans Claims was not jurisdictional, because Congress did not make clear its intent that the time limit at issue should be jurisdictional.

We are at a complete loss to see how the *Henderson* opinion, regarding a time limit on appeal of veterans' benefit rulings, has any relevance whatsoever to the case at bar involving the statute of limitations on assessment of federal income tax arising from the appellant's investment in a TEFRA partnership. *Henderson* in no way disturbs the law applicable to the instant appeal, i.e. (1) that I.R.C. §§6501 and 6229 work in tandem to provide the time limit for assessing partnership items and (2) that refund claims attributable to partnership items (as is appellant's statute of limitations claim here) cannot be brought in the individual partners' refund suit, but instead must be determined in the partnership-level proceeding in the Tax Court. (See Answering Br. at 35-52.) Indeed, in contrast with the time limit at issue in *Henderson*, I.R.C. §7422(h) expressly deprives the district courts of jurisdiction over refund claims attributable to partnership items. Moreover, it was long clear as a matter of case law that there was jurisdiction for the Tax Court to hear statute-of-limitations challenges in partner-level proceedings, even before Congress reaffirmed that conclusion with an express statutory provision. (See Answering Br. at 60-63.)

Henderson's analysis in the context of veterans benefits simply has no bearing on the issues presented in the case at bar, and appellant is grasping at straws in citing it to the Court. Because of *Henderson*'s lack of relevance to the

instant case, the further briefing appellant suggests is not warranted, and any motion in that regard should be denied.

Sincerely yours,

/s/ ELLEN PAGE DELSOLE

ELLEN PAGE DELSOLE
Attorney
Appellate Section

Case 10-20425 Document 00511424826 Page:1 Date Filed 03/25/2011

REDDING & ASSOCIATES, P.C.
Attorneys at Law
2914 West T.C. Jester
Houston, Texas 77018-7010
Telephone: (713) 965-9244 • Telecopier: (713) 621-5227

Thomas E. Redding, J.D. Teresa J. Womack, J.D.
Sallie W. Gladney, J.D.

March 25, 2011

Lyle W. Cayce, Clerk
United States Court of Appeals
for the Fifth Circuit
600 S. Maestri Place, Room 102
New Orleans, LA 70130

Re: *Sharon Scott, Ind. Executrix of the Est. of Edward O. Matthews, et al. v. United States of America*; Docket No. 10-20425

Dear Mr. Cayce:

This case is calendared for oral argument on April 27, 2011. Pending is Appellants' motion for leave to file a supplemental brief addressing the application of the Supreme Court's recent holdings in *Henderson v. Shinseki*, 2011 WL 691592 (U.S.). The United States objects, asserting that *Henderson* is restricted to "the unique system for review of veterans' benefits claims by the Veterans Court" and is, therefore, irrelevant to the jurisdictional issues presented in "ordinary"

litigation such as this tax refund suit. (Document 00511420317, p. 2). The United States neglects to inform this Court that the Supreme Court disagrees.

I write pursuant to Fed.R.App.P. 28(j), to inform the Court that on March 7, 2011, the Supreme Court remanded *U.S. v. Mann*, 373 Fed.Appx. 350, 2010 WL 1418308 (4th Cir. 2010) (copy attached), a criminal case, to the Fourth Circuit "for further consideration in light of *Henderson* . . . ." See the attached excerpt from the Supreme Court's order.

In *Henderson* the Supreme Court articulated four factors courts must apply to determine whether a statute is jurisdictional or nonjurisdictional within a complex procedural framework. *Henderson* concerned the jurisdictional consequences of 38 U.S.C. §7266(a) within the procedural framework of the Veterans' Judicial Review Act for the resolution of veterans' claims. *Henderson*, slip op. at 2. *Mann* concerned the jurisdictional consequences of 18 U.S.C. §3582(c)(2) within the procedural framework of the United States Sentencing Guidelines for criminal cases. *Mann*, at 2. The Supreme Court has made clear that the *Henderson* requirements apply to determine the jurisdictional consequences of *any* statute within *any* complex procedural framework. The *Henderson* requirements, therefore, apply to the jurisdictional consequences of both (i) 26 U.S.C. §6226(d)(1)(B), and (ii) the conflation of §6221 and

§7422(h), within TEFRA's procedural framework to resolve partnership-related tax issues for pre-1997 tax years, which are at the heart of this case.

Therefore, Appellants request that their supplemental brief addressing the application of *Henderson* be filed and that the United States, as it has requested, be granted two weeks to file its response. (Document 00511420317, p. 6). Appellants do not believe any delay in oral argument will be necessary.

Very truly yours,

REDDING & ASSOCIATES, P.C.

/s/ Sallie W. Gladney
Sallie W. Gladney,
Attorney for Appellants

SWG:jr
Attachment

U.S. Department of Justice
Tax Division

Please reply to Appellate Section

Facsimile No (202) 514-8456
P O. Box 502

Telephone No (202) 514-3361
Washington, D C 20044

EPDelSole
5-74-13292
CMN 2001101347

March 29, 2011

Lyle W. Cayce, Esquire
Clerk, U.S. Court of Appeals
for the Fifth Circuit
600 S. Maestri Place, Room 102
New Orleans, LA 70130

Re: Sharon Scott, et al. v. United States
(5th Cir. - No. 10-20425)

Dear Mr. Cayce:

We are responding to appellant's letter of March 25, 2011, in the above listed appeal, regarding the Supreme Court's order vacating and remanding the unpublished decision in *United States v. Mann*, 373 Fed. Appx. 350 (4th Cir. 2010), for further consideration in light of *Henderson v. Shinseki*, 131 S. Ct. 1197 (2011). Like *Henderson*, *Mann* involved a factual scenario and statutory scheme entirely distinct from that presented here. In *Mann*, the district court denied a criminal defendant's motion for reduction of sentence under 18 U.S.C. 2011 §3582(c) and his motion to amend that order. The

Fourth Circuit, raising jurisdiction on its own, determined that, under §3582(c), the district court lacked jurisdiction to reconsider the earlier request for sentence reduction. In ordering further consideration in light of *Henderson*, it appears that the Supreme Court views *Mann* as similarly presenting a question whether a statute that is not clearly jurisdictional should nevertheless be construed as imposing a jurisdictional rule.

Here, the Government has asserted that I.R.C. §7422(h) imposes a jurisdictional bar based on opinions of this Court and other appellate courts that directly address the statute at issue. (See Answering Br. 38-48.) Moreover, §7422(h) clearly expresses Congress's intent to restrict jurisdiction and is placed in a section that generally defines the scope of district courts' jurisdiction in tax refund suits. It is therefore unnecessary here to turn to the analysis conducted in an entirely different context to evaluate whether § 7422(h) imposes jurisdictional limits. But even if this Court were to determine that *Henderson*'s analysis were relevant here by analogy, *Henderson* -- which considered whether there was a case-law history of treating the statute as jurisdictional, and whether Congress made its intent clear through the wording and placement of the provision within the statutory scheme (131 S. Ct. at 1203-05) -- supports the Government's argument here.

We also note that a typographical error has come to our attention in our letter of March 11, 2011 regarding Henderson. At the top of page 2 of that letter, the reference to "partner-level proceedings" should read "partnership-level proceedings."

Sincerely yours,

/s/ ELLEN PAGE DELSOLE

ELLEN PAGE DELSOLE
Attorney
Appellate Section

IN THE UNITED STATES
DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

ALFONSO VARELA and SANDRA SANTA MARIA VARELA,	)	
Plaintiffs,	)	
v.	)	Civil No. 4:07-CV-343
UNITED STATES OF AMERICA,	)	
Defendant.	)	

UNITED STATES' RESPONSE
TO PLAINTIFF'S NOTICE
OF RECENT AUTHORITY

Defendant, United States of America, briefly responds to Plaintiff's [sic] Notice of Recent Authority (docket # 36) as follows.

In *Henderson v. Shinseki*, ___ U.S. ___, 131 S.Ct. 1197 (2011), the Supreme Court held that a rule regarding the time for appealing an adverse administrative ruling regarding veterans' benefits to the Court of Appeals for Veterans Claims was

not jurisdictional, because Congress did not make clear its intent that the time limit at issue should be jurisdictional.

Despite the fact that the Supreme Court recognized that there is a dramatic contrast between ordinary civil litigation and the system for adjudication of veterans' benefits claims, *id.* at 1205-06, and the fact that the Supreme Court clearly based its analysis of the jurisdictional issue there on the somewhat unique nature of the veterans' benefits claims system established by Congress, *see id.* at 1204-05, plaintiff appears to assert that *Henderson* has some applicability here, despite the fact that the present case is one of the "ordinary civil litigation" cases.

The Government is at a complete loss to see how the *Henderson* opinion has any relevance whatsoever to the case at bar involving the statute of limitations on assessment of federal income tax arising from the plaintiff's investment in a TEFRA partnership. Henderson in no way disturbs the law applicable to this case, i.e. (1) that 26 U.S.C. §§6501 and 6229 work in tandem to provide the time limit for assessing partnership items and (2) that refund claims attributable to partnership items (as is plaintiff's statute of limitations claim here) cannot be brought in the individual partners' refund suit, but instead must be determined in the partnership-level proceeding in the Tax Court. Indeed, in contrast with the time limit at issue in

Henderson, 26 U.S.C. §7422(h) expressly deprives this Court of jurisdiction over refund claims attributable to partnership items. Moreover, it was long clear as a matter of case law that there was jurisdiction for the Tax Court to hear statute-of-limitations challenges in partner-level proceedings, even before Congress reaffirmed that conclusion in 1997 with an express statutory provision.

Henderson's analysis in the context of veterans benefits simply has no bearing on the issues presented in the present case, and plaintiff is grasping at straws in citing it to the Court.

JOSÉ ANGEL MORENO
Acting United States Attorney

/s/ Michael D. Powell

MICHAEL D. POWELL
Bar No. 287121 - Florida
Trial Attorney, Tax Division
U.S. Department of Justice
717 N. Harwood, Suite 400
Dallas, Texas 75201
(214) 880-9757
(214) 880-9741 (fax)
michael.d.powell@usdoj.gov
ATTORNEY FOR UNITED STATES

IN THE UNITED STATES
COURT OF FEDERAL CLAIMS

No. 04-683 T

(Judge Marian Blank Horn)

(Consolidated with Nos. 05-695 T, 05-696 T, 05-1315 T, 05-1384 T, & 09-205 T)

JOHN E. KETTLE and ANNE R. KETTLE,

Plaintiffs,

v.

THE UNITED STATES,

Defendant.

DEFENDANT'S RESPONSE TO PLAINTIFFS' NOTICE

This past Sunday plaintiffs (Kettles, Ivys, Weidemanns) filed a six-page document (doc. #65) titled "notice of recent authority." The document goes far beyond the ordinary understanding of the words "notice" or "recent authority" as it includes six pages of argument replete with citation to cases dating from 1998 to 2006. The justification for the notice, assert plaintiffs, is that a March 1 decision

of the Supreme Court about the deadline for a veteran to appeal a denial of federal benefits trumps the Federal Circuit's explicit rejection of plaintiffs' untimely assessment and tax motivated interest claims. Plaintiffs' claim is outlandish and provides no justification for continuing this litigation.

In *Henderson v. Shinseki*, —U.S.—, 131 S. Ct. 1197 (2011), the Supreme Court held that the 120-day period for filing a notice of appeal to the United States Court of Appeals for Veterans Claims set forth in 38 U.S.C. §7266(a) was not jurisdictional. Here, in contrast, plaintiffs seek to litigate untimely assessment and tax motivated interest claims under the TEFRA partnership provisions. Plaintiffs' claims are the same as those that the Federal Circuit addressed in *Keener v. U.S.*, 551 U.S. 1358 (Fed. Cir. 2009) and *Prati v. U.S.*, 603 F.3d 1301 (Fed. Cir. 2010), and held were barred by 26 U.S.C. §7422(h) from being litigated in a partner-level refund action. The Henderson case dealt with the unique Title 38 statutory system for veterans claims. That system has no bearing at all on the Title 26 TEFRA partnership scheme, including the jurisdictional bar against partner-level suits that are attributable to partnership items. It would be difficult to select two more divergent topics. Henderson simply has nothing to do with plaintiffs' case and does not affect the Federal Circuit's binding guidance to this Court.

Yet plaintiffs employ *Henderson* to continue their sustained attack on the Federal Circuit, assigning error no less than seven times in their short brief (e.g. "the Federal Circuit's failure" (doc. #65 at pp. 2, 3 , 4), "the Federal Circuit never determined" (p.3), "the Federal Circuit conflated merits and jurisdiction" (p.4), "But the Federal Circuit . . . failed . . . and . . . conflated. . . ." (p.6), and "the Federal Circuit's 'drive-by jurisdictional ruling' in Prati" (p.6)). In sum, the "notice" is a continuation of plaintiffs' (increasingly) strained arguments that invite this Court to defy binding precedent. As we have explained, and the "notice" confirms, there is no basis for further litigation and the Court should dismiss all remaining untimely assessment and tax motivated interest claims.

Respectfully submitted,

3/16/2011
Date

s/Bart D. Jeffress
BART D. JEFFRESS
Attorney of Record
U.S. Department of Justice,
ax Division
Court of Federal Claims Section
Post Office Box 26,
Ben Franklin Post Office
Washington, D.C. 20044
(202) 307-6496
(202) 514-9440 (fax)

JOHN A. DiCICCO
Principal Deputy
Assistant Attorney General
STEVEN I. FRAHM
Chief, Court of Federal Claims
Section

3/16/2011
Date

s/Steven I. Frahm
Of Counsel

Attorneys for Defendant

IN THE UNITED STATES
COURT OF FEDERAL CLAIMS

No. 04-683 T

(Judge Marian Blank Horn)

(Consolidated with Nos. 05-695 T,
05-696 T, 05-1315 T, 05-1384 T, & 09-205 T)

JOHN E. KETTLE and ANNE R. KETTLE,

Plaintiffs,

v.

THE UNITED STATES,

Defendant.

JOINT STATUS REPORT

Pursuant to the Court's Order (doc. #52) filed on April 20, 2010, the parties provide the following quarterly joint status report.

Pending before the Court are six AMCOR cases, which divide into two groups. Group I has three cases: (1) *Kettle*, Fed. Cl. No. 04-683 T; (2) *Weidemann*, Fed. Cl. No. 05-1384 T; and (3) *Ivy*, Fed. Cl. No. 09-205 T. . . .

The fundamental substance of the parties' positions set forth in the Group I Report has not changed since January 18, 2011, when the parties filed a joint status report (doc. #60) . . . . Since filing the January 18 report, plaintiffs' counsel and defendant have filed multiple related JSRs in other AMCOR cases. In addition, with respect to the Group I cases, there have been the following developments: (1) plaintiffs moved to transfer the Group I cases to Judge Lettow, defendant opposed, and plaintiffs replied (*see* doc. ## 61, 63, 64); and (2) plaintiffs filed a first notice of additional authority to which defendant responded (*see* doc. ## 65, 67), and plaintiffs recently filed a second notice of additional authority (doc. #69) and a third notice of additional authority (doc. #70) (to both of which defendant does not believe a response is necessary). Accordingly, the parties provide this updated, stand-alone JSR.

I. Group I Report

The Court's Group I cases, *Kettle*, *Weidemann*, and *Ivy*, have two types of claims: (1) period of limitation (also referred to by the parties as untimely assessment claims); and (2) tax motivated interest. . . .

. . . .

B. Plaintiffs' Statement:

The Group I cases (*Kettle*, *Ivy*, and *Weidemann*) are three of 36 AMCOR-related suits

currently pending before multiple judges of this Court that involve the partners' individual §6501(a)-based limitations claims and §6621(c) penalty interest claims. . . . As discussed below, the partners in each of the 36 cases assert that their limitations and penalty interest claims, as applicable, . . . have jurisdictional issues that are ultimately controlled by the Supreme Court's recent holdings in *Henderson*;[5] issues that this Court must determine before the common limitations and penalty interest claims can be resolved.

To promote judicial efficiency and the efficient administration of justice, plaintiffs in the two suits before Judge Lettow have requested that their cases be consolidated for a single resolution of all common and partner-specific issues, if any.[6] To avoid conflicting opinions and 2-36 duplicative appeals of the same issues, plaintiffs in each of the other 34 cases, including the three Group I cases here, have requested that their suits be transferred to Judge Lettow for consolidation. (doc. #61). The government opposes any attempt to transfer or consolidate and instead requests that this Court

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[5] *Henderson v. Shinseki*, 131 S.Ct. 1197, 2011 WL 691592 (U.S., March 1, 2011).

[6] See doc. #22 filed February 25, 2011, in *Epps* (Fed.Cl. 06-615) and doc. #16 filed February 24, 2011 in *McCann* (Fed.Cl. 06-216).

sua sponte dismiss all relevant limitations and penalty interest claims without requiring that the government file appropriate motions.

. . . .

3. Plaintiffs' Group I Claims are Controlled by *Jade Trading* and *Henderson*, Not *Prati*

. . . .

On March 1, 2011, the Supreme Court issued *Henderson*. As relevant here, *Henderson* addresses two issues. The first applies to the Group I plaintiffs' limitations claims. The second applies to both their limitations and also penalty interest claims. First, *Henderson* articulates four factors courts must apply to determine whether a provision within a complex procedural framework has "jurisdictional consequences" or is merely a "claim-processing rule" that can be equitably ignored. Second, *Henderson* extends the Supreme Court's general analysis in *Arbaugh*[36] (addressing the conflation of jurisdiction and merits before Article III courts) to Article I courts.

As to their limitations claims, *Henderson* has now established four factors that determine

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[36] *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006), relying on *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83 (1998).

whether a provision has "jurisdictional consequences" or is merely a "claim-processing rule" that courts may ignore under equitable principles:[37]

(1) Do the provision's terms evidence that it was meant to carry jurisdictional consequences?

(2) Does Congress' placement of the provision within the relevant procedural framework indicate it was intended to be jurisdictional?

(3) Is there a separate jurisdictional provision within the relevant procedural framework?

(4) Does holding a provision to be jurisdictional support or conflict with the relevant procedural framework?

Section 6226(c) is the only provision granting personal jurisdiction over partners in partnership-level suits. For pre-1997 tax years, §6226(d)(1)(B) plainly states that §6226(c) "shall not apply" to partners after the date their assessment deadline expires. Pre-1997 §6226(d)(1)(B) bars the participation of any partner whose assessment deadline has expired, regardless of whether that

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[37] *Henderson*, slip op. 8-12.

deadline is classified as a partnership item, a nonpartnership item, or an affected item.

Applying the *Henderson* factors here makes clear that pre-1997 §6226(d)(1)(B) is jurisdictional and may not be ignored. In *Prati* and *Keener*, the Federal Circuit never determined that those partners' assessment deadlines had not expired before the partnership-level suits were filed. Rather, without addressing the jurisdictional consequences of §6226(d)(1)(B) for the pre-1997 tax years in issue, it held that those partners were required to have raised their limitations claims in the partnership-level suits. The Federal Circuit's failure in *Prati*, and also *Keener*, to address the jurisdictional consequences of pre-1997 §6226(d)(1)(B) cannot stand in light of the Supreme Court's holding in *Henderson*.[38] Therefore, summary dismissal of the Group I plaintiffs' cases is inappropriate and this Court must determine, *inter alia*, the proper application of the *Henderson* factors to pre-1997 §6226(d)(1)(B) for purposes of their limitations claims.

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[38] On March 8, 2011, a petition for writs of certiorari was filed with the Supreme Court addressing *Henderson*'s application to pre-1997 §6226(d)(1)(B) for 53 appeals in which the Federal Circuit summarily affirmed dismissals based on *Prati*. (*Keefe, et al. v. United States* S.Ct. 10-1105).

The Group I plaintiffs also assert, *inter alia*, that *Prati* cannot control either their limitations claims or their penalty interest claims because, *inter alia*, in *Prati* the Federal Circuit conflated merits and jurisdiction as to both issues. This conflation was a direct result of the Federal Circuit's failure to apply its prior precedent in *Jade Trading* as to the proper classification of and jurisdiction to determine affected items.

In *Steel*[39] the Supreme Court recognized and rejected the so-called "doctrine of hypothetical jurisdiction" which the Ninth Circuit had characterized as " 'assuming' jurisdiction for the purpose of deciding the merits."[40] In *Arbaugh*, the Supreme Court relied on *Steel* and *Da Silva*[41] in recognizing that opinions based on the conflation of merits and jurisdiction have no precedential value:

> Judicial opinions . . . "often obscure the issue by stating that the court is dismissing 'for lack of jurisdiction' when some threshold fact has not been

---

[39] *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 91 (1998).

[40] *Steel*, 523 U.S. at 94, quoting *United States v. Troescher*, 99 F.3d 933, 934, n. 1 (9th Cir. 1996).

[41] *Da Silva v. Kinsho International Corp.*, 229 F.3d 358 (2nd Cir. 2000).

> established, without explicitly considering whether the dismissal should be for lack of subject matter jurisdiction or for failure to state a claim." *Da Silva*, 229 F.3d, at 361. We have described such unrefined dispositions as "drive-by jurisdictional rulings" that should be accorded "no precedential effect" on the question whether the federal court had authority to adjudicate the claim in suit. *Steel Co.*, 523 U.S., at 91, 118 S.Ct. 1003.[42]

Attempting to end the use of merits determinations as "drive-by jurisdictional rulings," the Supreme Court in *Arbaugh* established the intent of Congress as a "readily administrable bright line" test to determine a provision's jurisdictional consequences.[43] But the "drive-by jurisdictional rulings" continued.

Steel and *Arbaugh* addressed purported jurisdictional determinations by Article III courts. *Henderson* has now established that *Arbaugh*'s "readily administrable bright line" test also applies to jurisdictional determinations by Article I courts.[44] The Supreme Court then specifically

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[42] *Arbaugh*, 546 U.S. at 1242-43.

[43] *Arbaugh*, 546 U.S. at 1245.

[44] *Henderson*, slip op. 6.

articulated the four factors listed above that courts must apply to determine when a provision is jurisdictional.

In *Henderson*, the Supreme Court held that the 38 U.S.C. §7266(a) deadline to appeal to the Article I Veterans Court is not jurisdictional.[45] Here, the issue is where and when, within TEFRA's procedural scheme, plaintiffs are allowed/required to raise their §6501(a)-based limitations claims and §6621(c) penalty interest claims. The options are either in the partnership-level suit before the Tax Court (an Article I court), or in this partner-level refund suit (before this Article I court).

In *Prati*, the Federal Circuit held that both claims could be raised only in the partnership-level Tax Court suits.[46] But the Federal Circuit:

(i) as to limitations, failed to address the existence, plain language, and purpose of §6226(d)(1)(B)'s jurisdictional bar for pre-TEFRA tax years and;

(ii) as to both issues, conflated

(a) §7422(h) (no jurisdiction over the claim where refund is attributable to partnership items) and

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[45] *Henderson*, slip op. 12.

[46] *Prati*, 1307-08 and n.4.

> (b) §6221 (no jurisdiction to determine the merits of partnership-item elements where refund is attributable to affected items, but jurisdiction does exist to determine the nonpartnership-item elements and the affected item itself by applying any partnership-item elements previously determined in any partnership-item proceeding binding on that partner).[47]

Therefore, under *Henderson*, the Federal Circuit's "drive-by jurisdictional ruling" in *Prati* should be accorded no precedential effect on the question of whether this court has authority to adjudicate plaintiffs' claims.

The government argues that *Henderson* applies only to veterans claims and is, therefore, irrelevant to the jurisdictional issues presented in this tax refund suit. The Supreme Court disagrees. On March 7, 2011, the Supreme Court remanded *U.S. v. Mann*, 373 Fed.Appx. 350, 2010 WL 1418308 (4th Cir. 2010), a criminal case, to the Fourth Circuit "for further consideration in light of *Henderson* . . .", evidencing that the Supreme Court does not consider *Henderson* to be restricted only to veterans cases. By remanding *Mann*, the

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[47] *Jade Trading, LLC v. United States*, 598 F.3d 1372, 1378-79 (Fed.Cir. 2010).

Supreme Court made clear that the *Henderson* requirements apply to determine the jurisdictional consequences of *any* statute within *any* complex procedural framework.

On March 14, 2011, the Tenth Circuit issued *Springer*,[48] recognizing that the Supreme Court's *Henderson* analysis applies to determine the jurisdictional consequences of tax statutes in Tax Court suits. Specifically, the Tenth Circuit recognized

> Like the Veterans Court, the Tax Court is also an Article I court. However, the Congressional scheme defining the Tax Court's jurisdiction is significantly different from "the unique administrative scheme" for veterans-benefit review and the Veterans Court's place in it, as described in *Henderson*. *See Henderson*, 2011 WL 691592, at *7. Most significantly, the terms of 26 U.S.C. §6330(d)(1) clearly refer to the Tax Court's jurisdiction. *Cf. Henderson*, 2011 WL 691592, at *8 (noting first, among several factors, that statute

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[48] *Springer v. Commissioner*, 2011 WL 899718 (10th Cir. March 14, 2011) (unpublished). As the Tenth Circuit noted, its unpublished opinion is "not binding precedent" in any other case but "may be cited . . . for its persuasive value consistent with Fed.R.App.P. 32.1 and 10th Cir.R. 32.1." *Id.*, at fn*.

> allowing Veterans Court's review of benefits decision "do[es] not suggest, much less provide clear evidence, that the provision was meant to carry jurisdictional consequences"). Under the Supreme Court's analysis in *Henderson*, the requirements for an appeal to the Tax Court under 26 U.S.C. §6330(d)(1) are jurisdictional.

Springer, slip op. p. 4 n. 1. See the copy attached.

The Tenth Circuit acknowledged that the administrative and procedural schemes for veterans' claims before the Veterans Court and for taxpayer claims before the Tax Court are distinctly different, but that the factors articulated by the Supreme Court in *Henderson* do apply to determine the jurisdictional consequences of *any* statute within *any* complex procedural framework, the analytical approach the Group I plaintiffs advocate here.

In this case, the *Henderson* factors/requirements apply to the jurisdictional consequences of both (i) 26 U.S.C. §6226(d)(1)(B), and (ii) the conflation of §6221 and §7422(h), within TEFRA's procedural framework to resolve partnership-related tax issues for pre-1997 tax years. When those factors are applied here it is clear that:

for pre-1997 tax years, under a *Henderson* analysis, §6226(d)(1)(B) is jurisdictional – just as the Tenth Circuit held that 26 U.S.C. §6330(d)(1) is jurisdictional – and, therefore, pre-1997 §6226(d)(1)(B) barred partners with expired assessment deadlines from participating in partnership-level Tax Court suits; and

the jurisdictional conflation of §§6221 and 7422(h) cannot bar all affected item claims from this Court's existing refund jurisdiction under 28 U.S.C. §§1340, 1346(a)(1), and 1491(a)(1).

. . . .

C. **Defendant's Statement:**

. . . .

2. **Defendant will seek sanctions for any further litigation of plaintiffs' untimely assessment and tax motivated interest claims.**

Because there is no basis for further litigation, any continued maintenance of period of limitation and tax motivated interest claims in the face of the Federal Circuit's decisions in *Keener* and *Prati* will prompt a motion by defendant for all sanctions permitted by law, including sanctions under RCFC 11(b)(2), (c) (for pressing unwarranted and frivolous legal claims) and payment by plaintiffs'

counsel of excess costs, expenses, and attorneys' fees under 28 U.S.C. §1927 ("Any attorney . . . admitted to conduct cases in any court of the United States . . . who so multiplies the proceedings in any case unreasonably and vexastiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct."). *See e.g. Phonometrics, Inc. v. Westin Hotel Co.*, 350 F.3d 1242 (Fed. Cir. 2003) (applying Eleventh Circuit law and affirming trial court's award under 28 U.S.C. §1927 for litigant's continued maintenance of infringement claims after a decision by the Federal Circuit in a related case precluded litigant from prevailing on its claims).

3. Response to Plaintiffs' Statement.

. . . .

a. There is no reason to transfer the Group I cases.

. . . .

Finally with regard to plaintiffs' motions to transfer, we filed a response (doc. #67) to plaintiffs' "notice of recent authority," explaining that the Supreme Court's decision in *Henderson v. Shinseki*, —U.S.—, 131 S. Ct. 1197 (2011) about a deadline for veterans' appeals simply has nothing to do with the Group I plaintiffs' claims and does not affect the Federal Circuit's binding guidance to

this Court. Defendant does not believe a response is necessary to plaintiffs' recently filed second notice (doc. #69) and third notice (doc. #70) but will provide one if the Court believes it would be helpful.

. . . .

Defendant's attorney has authorized plaintiffs' attorney to sign this joint status report on his behalf.

Respectfully submitted,

4/01/2011
Date

s/Thomas E. Redding
THOMAS E. REDDING
Redding & Associates, P.C.
P.O. Box 924328
Houston, Texas 77292-4328
(713) 965-9244
(713) 621-5227 (fax)

Attorney for Plaintiffs

4/01/2011
Date

s/Bart D. Jeffress
by s/Thomas E. Redding
BART D. JEFFRESS
Attorney of Record
U.S. Department of Justice
Tax Division
Court of Federal Claims Section
Post Office Box 26

Ben Franklin Post Office
Washington, D.C. 20044
(202) 307-6496
(202) 514-9440 (fax)

JOHN A. DiCICCO
Principal Deputy
Assistant Attorney General
STEVEN I. FRAHM
Chief, Court of Federal
Claims Section

s/Steven I. Frahm
4/01/2011 by s/Thomas E. Redding
Date Of Counsel

Attorneys for Defendant